INTRODUCTION

This Article examines a recent fundamental shift in the character of securities class action litigation. Whereas securities cases historically were anchored by financial or accounting fraud, increasingly such actions are premised on the alleged concealment of, or misrepresentation concerning,
the risk of adverse events that negatively impact stock performance. This new focus is the defining characteristic of event-driven securities litigation (EDSL), which has been controversial for multiple reasons. The Article examines the controversy in four parts. Part I examines the ascent of event-driven securities litigation. Part II examines seven recurring issues in the litigation, with an emphasis on these topics in EDSL involving the life sciences sector. Part III takes a deeper dive and analyzes six discrete categories of EDSL: (A) COVID-19, (B) cannabis, (C) corruption, (D) antitrust, (E) #MeToo, and (F) cybersecurity. Part IV discusses common proposed solutions to the perceived plague of event-driven securities litigation. The Article concludes that critiques of EDSL are mostly unjustified.

I. THE ASCENT OF EDSL

Securities class action litigation has experienced a major transformation in recent years. Complaints filed in securities class actions asserting violations of section 10 of the Securities Exchange Act of 1934 (Exchange Act) and companion Rule 10b-5, section 11 of the Securities Act of 1933 (Securities Act), and/or section 12 of the Securities Act are often referred to as core or standard filings. From 2009–2014, between 51% and 68% of...
the core filings alleged (a) false statements in the defendant company’s financial statements and/or (b) false projections of defendant’s future earnings. Many of the filings during this period and earlier were made after defendants announced restatements of their financial statements. Major event-driven filings also occurred, and they date back at least to 2010, but they were uncommon.

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

Simultaneously, financial statement restatements and the share of core


10. See 2018 Full-Year Review, supra note 6, at 17.

filings alleging a restatement both sharply declined. The number of restatements peaked in the years immediately following the enactment of the Sarbanes-Oxley Act of 2002 (SOX)\(^\text{12}\) and has plunged since then.\(^\text{13}\) In 2020 restatements reached a 20-year low.\(^\text{14}\) The number of reissuance restatements—those addressing a material error\(^\text{15}\) that called for the reissuance of a prior financial statement—decreased every year from 2006–2017, increased slightly in 2018, and reached a nadir in 2020.\(^\text{16}\) In 2020 only 80 companies issued restatements, compared with more than 300 companies in 2011.\(^\text{17}\) And in 2020 only 5% of core securities class action filings alleged a restatement,\(^\text{18}\) compared with 10% in 2016 and 19% in 2014.\(^\text{19}\)

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


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

\(^{16}\) 2020 FINANCIAL RESTATEMENTS, supra note 14, at 5.


2019, and then declined to 326 new filings in 2020, possibly as a short-term repercussion of the COVID-19 pandemic.\(^{21}\) In 2020 the ratio of new filings to listed companies declined to 5.7%, but this measure was still higher than the annual ratios during the first twenty years following the enactment of the Private Securities Litigation Reform Act (PSLRA)\(^{22}\) in 1995.\(^{23}\)

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

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

\(^{21}\) Id.


\(^{23}\) See 2020 FULL-YEAR REVIEW, supra note 20, at 2 (setting forth statistics).

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

\(^{25}\) 2020 FULL-YEAR REVIEW, supra note 20, at 3.

\(^{26}\) Id.

\(^{27}\) 2018 FULL-YEAR REVIEW, supra note 6, at 6.

\(^{28}\) In re Trulia S’holder Sec. Litig., 129 A.3d 884, 898 (Del. Ch. 2016).


[T]he character of securities litigation has recently changed. Once, securities class actions were largely about financial disclosures. . . . In this world, the biggest disaster was an accounting restatement. Now the biggest disaster may be
defendant company’s stock price drops following the disclosure or occurrence of a negative event which plaintiffs link to prior soft statements by the issuer that it was in regulatory compliance, its internal controls were effective, or it adhered to its corporate code of conduct or ethics. The underlying theory in most of these actions is that the occurrence or event upon which the case is based was the materialization of an undisclosed or an under-disclosed risk that caused a stock price drop.\textsuperscript{30} This differs from traditional accounting fraud cases which are usually initiated following a corrective disclosure—in which a company corrects a false or misleading statement or omission—that is alleged to have caused a price drop.\textsuperscript{31}

Complaints in event-driven cases are often filed in the immediate aftermath of a stock’s price decline, whereas complaints in traditional accounting cases are generally filed only after months of investigation by plaintiffs’ counsel.\textsuperscript{32} However, an inference that EDSL pleadings therefore must be considerably flimsier is undercut by at least three factors. First, EDSL complaints commonly free-ride on both government investigations into defendant firms’ misconduct\textsuperscript{33} and the associated press coverage. Indeed, government investigations and enforcement proceedings are a major catalyst for event-driven litigation.\textsuperscript{34} Second, other EDSL follows consumer cases in which discovery has already occurred.\textsuperscript{35} Third, plaintiffs in the

\footnotesize{a literal disaster…. The best characterization for this new type of securities litigation is that it is ‘event-driven’ litigation.}

\textsuperscript{30} New Driver, supra note 1, at 4 ("The main theory in the event-driven cases is that the occurrence or event upon which the case is based was the materialization of an undisclosed or downplayed risk.").

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


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

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

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

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


41. Stuff Happens, supra note 9.

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

43. See id. at 12 (“Over the past couple of years, growth in aggregate Investor Losses was concentrated in filings alleging regulatory violations, a substantial number of which were also event-driven securities cases. . . .”).
rise of EDSL has continued since then. One report concluded that the number of new event-driven filings increased from 34 in 2018 to 47 in 2020, and even this is a significant under-count insofar as it excludes, *inter alia*, most filings in the life sciences sector and antitrust-driven securities litigation. Suits against foreign companies whose securities are traded on U.S.-based exchanges have been a major component of EDSL, consistent with the recent overall increase in suits involving such companies. The share of securities fraud class actions filed against non-U.S. issuers spiked from 15% in 2019 to 27% (88 cases) in 2020.

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

44. See *New Driver*, supra note 1 (setting forth statistics).
48. See Kevin LaCroix, *Scrutinizing Event-Driven Securities Litigation*, D&O DIARY (Mar. 27, 2018), https://www.dandodiary.com/2018/03/articles/securities-litigation/scrutinizing-event-driven-securities-litigation/ [https://perma.cc/877G-WWL4] (noting emergence of two-tier plaintiffs’ bar in securities class action litigation, in which older, more established firms focus on financial fraud cases while new entrants focus on event-driven cases “because that is what is left to them”).
But their filings did not ignore traditional accounting fraud and, conversely, non-RPG traditional plaintiffs’ firms make numerous EDSL filings. In 2018 the RPG Firms served as lead or co-lead counsel in more settlements of traditional securities class actions with accounting allegations than any other plaintiffs’ firm, and a 2021 analysis of filings concluded that “[t]he cream of the shareholder bar . . . is betting on event-driven securities class actions.”

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


56. Id.

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

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

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

58. Id. at 12.
60. 2019 SETTLEMENTS, supra note 57, at 12.
61. Top 100 Settlements, supra note 8, at 11.
62. See, e.g., Serena Hallowell, Alec Coquin & Jake Bissell-Linsk, Mutual Funds Should Consider Shareholder Litigation, LAW360 (Oct. 8, 2019, 12:43 PM), https://www.law360.com/classaction/articles/1206257/mutual-funds-should-consider-shareholder-litigation [https://perma.cc/Z6BV-BBZ6] (observing that institutional investors make good lead plaintiffs because they are likely to have a substantial interest in the outcome of the litigation, typically have adequate record-keeping regarding their investments, are not susceptible to the disruptions caused by changing life circumstances that can affect individuals, and are experienced fiduciaries and sophisticated consumers of legal services).
64. See Adam C. Pritchard & Stephen J. Choi, Lead Plaintiffs and Their Lawyers: Mission Accomplished, or More to Be Done?, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG. (May 25, 2017), https://corpgov.law.harvard.edu/2017/05/25/lead-plaintiffs-and-their-lawyers-mission-accomplished-or-more-to-be-done/ [https://perma.cc/NYW6-BR4T] (suggesting that “some class action law firms are buying lead counsel status with campaign contributions”); Drew T. Johnson-Skinner, Note, Paying-to-Play in Securities Class Actions: A Look at Lawyers’ Campaign Contributions, 84 N.Y.U. L. REV. 1725, 1750 (2009) (“[P]laintiffs’ law firms are contributing to the pension funds that select them as counsel. . . . [I]t is clear that the campaign contributions that could be the basis of paying-to-play are present across a broad range of cases. The amount of money contributed by firms is also significant.”).
and a prime reason newer plaintiffs’ firms are unable to form relationships with major institutional investors is they cannot afford to ante up.65 Accordingly, a reduced role for pension funds as lead plaintiffs in securities class actions may be advantageous.

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

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

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

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66. See Top 100 Settlements, supra note 8, at 13 (listing top 100 settlements).
67. Id. at 13–19.
70. See, e.g., Andrew J. Pincus, Back to the Future: Jump in Securities Class Actions Shows Need for Reform, 24 (No. 25) WESTLAW J. SEC. LITIG. & REG. (Apr. 11, 2019) (noting higher dismissal rates for cases filed by RPG Firms).
71. 2020 YEAR IN REVIEW, supra note 18, at 34.
72. Id.
73. See Strauss, supra note 33 (reporting dismissal rates).
74. See U.S. CHAMBER INST. FOR LEGAL REFORM, CONTAINING THE CONTAGION:
II. RECURRING EDSL ISSUES

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

A. Corporate Mismanagement as Securities Fraud

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

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

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

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

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

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

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80. Id. at 479 (citing Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971)).
81. 918 F.3d 57, 59–60 (2d Cir. 2019). The Second Circuit added: “The attempt relies on a simple equation: first, point to banal and vague corporate statements affirming the importance of regulatory compliance; next, point to significant regulatory violations; and *voila*, you have alleged a prima facie case of securities fraud!” Id.
82. See, e.g., *In re Hertz Global Holdings, Inc.*, 905 F.3d 106, 117 (3d Cir. 2018) (“[W]e have long held ‘that an allegation of mismanagement on the part of a defendant will not alone support’ a securities fraud claim.”); *City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Waters Corp.*, 632 F.3d 751, 760 (1st Cir. 2011) (“Allocation of corporate mismanagement are not actionable under Rule 10b-5.”); *Acito v. IMCERA Grp., Inc.*, 47 F.3d 47, 55 (2d Cir. 1995) (“It is well settled that section 10(b) was not designed to regulate corporate mismanagement.”).
85. Id.
to deceive, manipulate, or defraud.”

Pursuant to the Supreme Court’s decision in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, a complaint adequately pleads scienter “only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.”

Where a defendant is a corporation, *Tellabs* requires pleading facts that give rise to a strong inference that an individual whose intent could be imputed to the corporation acted with the requisite scienter.

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

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

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


89. Id. at 323.

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


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

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

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

96. See 17 C.F.R. § 240.10b-5(b) (2021).
98. See THOMAS LEE HAZEN, 4 TREATISE ON THE LAW OF SECURITIES REGULATION § 12.191 (May 2021 Update) (“The fact that mismanagement is involved does not preclude a Rule 10b-5 claim for material misrepresentation.”).
99. Top 100 Settlements, supra note 8, at 24–25.
100. Id.
103. See, e.g., Karth v. Keryx Biopharm., 6 F.4th 123, 135 (1st Cir. 2021) (stating that plaintiff may not plead fraud by hindsight); In re Triangle Cap. Corp. Sec. Litig., 988 F.3d 743, 754–55 (4th Cir. 2021) (stating that plaintiff is not permitted to “use the benefit of 20-20 hindsight to turn management’s business judgment into securities fraud”) (citing In re Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1419 (9th Cir. 1994)); In re 3M Co. Sec. Litig., No. 20-CV-2488, 2021 WL 4482987, at *10 (D. Minn. Sept. 30, 2021) (dismissing action against 3M in large part because plaintiffs were pleading fraud by hindsight). See also Mitu Gulati, Jeffrey J. Rachlinski & Donald C. Langevoort, Fraud by Hindsight, 98 NW. U. L. REV. 773, 775 (2004) (“Courts cite concerns with hindsight in nearly one-third of all published opinions in securities class action cases.”).
104. Gulati, Rachlinski & Langevoort, supra note 103, at 776-77.
dismiss stage of securities litigation. But it does not permit an obvious or even principled demarcation between fraud and mistake.

B. The Matrixx Effect

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

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

105. Id. at 825 (“Instead of developing the doctrine into a clear rule about what constitutes fraud by hindsight, judges rely on their own intuition to sort out facts that suggest real problems and facts that suggest nothing more than fraud by hindsight.”).
110. Id. at 231–32.
111. Id. at 825.
112. See Stephen M. Goodman, If You Smell Smoke, When Do You Report the Fire? The Impact of the Matrixx Case on Disclosure of Adverse Event Reports, 9 PHARM. L. & INDUS. REP. 652 (May 27, 2011) (“[A]s a result of Matrixx, the first whiff of smoke may force a drugmaker to make a public disclosure of the possibility that its drug is causing a fire, even
allegation of statistical significance to establish the requisite strong inference of scienter under section 10(b) and Rule 10b-5.\textsuperscript{113}

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

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

Ten years later the impact of the Court’s refusal to adopt a bright-line standard in \textit{Matrixx} has been most evident in two respects. First, companies continue to lack direction about their disclosure obligations, especially regarding the clinical trial data that underlie much of the disclosures in the life sciences sector.\textsuperscript{118} The uncertainty concerning such data—which, combined with evaluations, often totals thousands of pages—\textsuperscript{119} has been compounded by other factors. The PSLRA’s statutory safe harbor—which protects forward-looking soft information accompanied by adequate cautionary language—does not protect such hard data as the information derived from clinical trials\textsuperscript{120} or forward-looking statements made in initial

\textsuperscript{113} 563 U.S. at 48–49.
\textsuperscript{114} See Coffee, Distinctions, supra note 32 (advancing this argument).
\textsuperscript{115} Stuff Happens, supra note 9.
\textsuperscript{116} 563 U.S. at 43–47.
public offering (IPO) registration statements.\textsuperscript{121} Life sciences companies also are handicapped by a general absence of guidance from the SEC concerning disclosure requirements.\textsuperscript{122}

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

Because biotechnology and pharmaceutical companies are disproportionately impacted by event-driven litigation it is useful to consider how defendants in this sector have fared on motions to dismiss in the post-\textit{Matrixx} era. A 2017 survey examined all 61 district court decisions on motions to dismiss federal securities claims from 2005–2016 where the defendant biotechnology company did not already have a drug or device on the market and its alleged false or misleading statements concerned clinical trials or the FDA approval process for its primary drug or device candidate. During the post-\textit{Matrixx} period 2012–2016, 78% of the decisions resulted in complete dismissals, compared with only 56% of the decisions during the pre-\textit{Matrixx} period of 2005–2011.\textsuperscript{126}

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

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\item \textsuperscript{121} See 15 U.S.C. § 78u-5(b)(2)(D) (setting forth IPO exclusion).
\item \textsuperscript{123} Singh v. Cigna Corp., 918 F.3d 57, 630–64 (2d Cir. 2019).
\item \textsuperscript{124} 563 U.S. at 33 n.2.
\item \textsuperscript{125} See, e.g., Schaeffer v. Nabriva Therapeutics PLC, 19 Civ. 4183 (VM), 2020 WL 7701463, at *9 (S.D.N.Y. Apr. 28, 2020) (granting motion to dismiss in large part because alleged misrepresentations were puffery).
\end{itemize}
25% of all securities fraud lawsuits, and this share was similar in 2019.\(^\text{127}\) Two of the three RPG Firms were two of the top four leaders in the 2020 sector filings.\(^\text{128}\) Life sciences companies present an attractive EDSL target for multiple reasons. Clinical stage ventures often must tap capital markets to fund expensive drug trials, exposing them to potential liability under the more lenient standards applicable to securities claims involving IPOs.\(^\text{129}\) In addition, the prospects of drug companies are highly dependent on the unpredictable regulatory approval process. A setback at any stage can present disclosure issues. An unexpected adverse approval decision by the FDA typically results in an immediate precipitous stock price decline,\(^\text{130}\) which may be especially severe for a newly public clinical stage company with a single product candidate. Market volatility caused by the COVID-19 pandemic exacerbated this concern for numerous small-cap newly public life sciences companies whose stock prices dipped below their IPO prices in 2020.\(^\text{131}\)

Motions to dismiss are filed in nearly all life sciences EDSL. In 2020 courts issued 43 opinions in class actions in the life sciences sector, 24 of which concerned allegations of misrepresentations during product development. Of the 24 cases, courts dismissed 15 in whole and five in part, including appellate decisions affirming lower courts’ dismissal orders.\(^\text{132}\) Winning arguments for defendants encompassed both materiality and scienter.\(^\text{133}\) In 2020 courts also issued six opinions addressing fraud claims that arose after a drug or medical device’s development process. Of the six cases, five were dismissed in whole and one was dismissed in part.\(^\text{134}\) *Matrixx* was not particularly helpful to plaintiffs in the foregoing litigation.\(^\text{135}\)


\(^{128}\) Id. at 6.


\(^{131}\) 2019 Roundup, supra note 129.

\(^{132}\) Dechert 2021 Survey, supra note 127, at 11–12.

\(^{133}\) Id. at 12–14.

\(^{134}\) Id. at 14.

\(^{135}\) See, e.g., Nguyen v. Endologix, Inc., 962 F.3d 405 418 (9th Cir. 2020) (affirming dismissal of class action and rejecting plaintiff’s reliance on *Matrixx*).
and overall, the developing body of case law in life sciences EDSL has been generally defense-friendly.

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

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

1. Omnicare

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

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

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136. 575 U.S. at 185.
137. Id. at 183–87, 189.
“provided a hook on which plaintiffs tie event-driven suits.”

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

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

142. Coffee, supra note 139.
144. Golub v. Gigamon Inc., 994 F.3d 1102, 1107 (9th Cir. 2021).
146. Jaroslawicz v. M&T Bank Corp., 912 F.3d 96 (3d Cir. 2018); In re Amarin Corp. PLC Sec. Litig., 689 F. App’x 124, 132 n.12 (3d Cir. 2017).
147. Tongue v. Sanofi, 816 F.3d 199 (2d Cir. 2016); Police & Ret. Sys. of City of Detroit v. Plains All Am. Pipeline, L.P., 777 F. App’x 726, 730 (5th Cir. 2019); Nakkhumpun v. Taylor, 782 F.3d 1142, 1159 (10th Cir. 2015); Carveli v. Owren Fin. Corp., 934 F.3d 1307, 1322 (11th Cir. 2019).
Prior to *Omnicare* courts tended to find opinion statements non-actionable in life sciences cases for multiple reasons, including defendants’ common argument that the statements were immaterial puffery. Now, motions to dismiss in life sciences EDSL often turn on *Omnicare*’s application. While some attorneys believe the decision has provided a firmer foundation for dismissal, federal courts appear to disagree as to whether *Omnicare* expanded or restricted liability for opinion statements. For example, in a pair of contrasting 2020 decisions the Second Circuit stated that *Omnicare* increased plaintiffs’ ability to plead an actionable opinion, whereas the Third Circuit observed that *Omnicare* imposed a rigorous benchmark. The judicial disagreement appears intertwined with the courts’ somewhat inconsistent articulation of *Omnicare*’s requirements. Nevertheless, the judicial application of *Omnicare* to biotechnology claims has resulted in a higher dismissal rate than the overall rate for securities class actions.

The higher dismissal rate in post-*Omnicare* life sciences EDSL may be explained by *Omnicare*’s acknowledgement that when evaluating opinion statements investors take into account “the customs and practices of the relevant industry.” This might be especially important in the pharmaceutical industry, where manufacturers and the FDA engage in an ongoing dialogue about clinical trials during the drug approval process.
importance of the factor is magnified in the case of sophisticated investors, who should understand that optimistic statements by issuers about the likelihood of drug approval do not constitute assurances of success.  

2. The Puffery Problem and Codes of Conduct

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

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

159. Id. at 211–12.
162. City of Pontiac Policemen’s & Firemen’s Ret. Sys. v. UBS AG, 752 F.3d 175, 183 (2d Cir. 2014).
164. Indiana Pub. Ret. Sys. v. SAIC, Inc., 818 F.3d 85, 98 (2d Cir. 2016); In re Petrobras Sec. Litig., 116 F. Supp. 3d 368, 381 (S.D.N.Y. 2015) (“Whether a representation is ‘mere puffery’ depends, in part, on the context in which it is made.”).
misleading always depends on context.”

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

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

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165. Omnicare, 575 U.S. at 190.
166. Davis Polk & Wardwell LLP, Client Memorandum, Codes of Ethics and Securities Litigation (Apr. 30, 2020), https://www.davispolk.com/sites/default/files/codes_of_ethics_and_securities_litigation.pdf ("[F]ederal securities lawsuits targeting statements about corporate codes of ethics are now common in so-called ‘event-driven’ cases... ").
169. 17 C.F.R. § 229.406(a), (c) (2021).
accounting officers and do not require code adoption.173

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

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

176. See DAVIS POLK & WARDWELL LLP, supra note 166.
177. Id.
The foregoing outcomes are driven in large part by a concern about creating a rule that would “turn all corporate wrongdoing into securities fraud.” The judicial solution to that concern has been to usually deem statements in codes of conduct and ethics immaterial as a matter of law. This solution directly counters Congress (as expressed in SOX), the SEC, the NYSE, and Nasdaq, which collectively determined that codes of conduct and ethics are of such high importance to investors that they must be adopted and disclosed.

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

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


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

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

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

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

D. Items 103 and 303

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


189. 563 U.S. at 45.


191. Id.


For U.S. reporting companies the principal disclosure requirements are set forth in Regulation S-K (Reg S-K), which governs required disclosures in a company’s periodic Form 10-K and 10-Q filings. EDSL complaints often allege violations of S-K Items 103 and 303. The former requires a brief description of any material and pending non-routine legal proceedings against the issuer or one of its subsidiaries. The instructions for Item 103 add that issuers must disclose “any such proceedings known to be contemplated by governmental authorities.” Courts have interpreted this language to require disclosure only of actions “substantially certain to occur.” As noted by Professor Langevoort, “this standard truncates the duty considerably.”

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

194. See, e.g., Gregg L. Weiner & Israel David, Next ‘Trend’ in Securities Litigation: Fraud Cases Brought Under Item 303, N.Y. L.J., May 28, 2015, https://www.friedfrank.com/siteFiles/Publications/ NYLJ%20060622015.pdf [https://perma.cc/57FX-75WH]. Item 105 of Reg S-K also provides a basis for EDSL. Item 105, most recently amended in 2020, requires that, where appropriate, companies must: (1) provide under the caption “Risk Factors” a discussion of the material factors that make an investment in the registrant or offering speculative or risky, and (2) concisely explain how each risk affects the registrant or the securities being offered. 17 C.F.R. § 229.105 (2021). The 2020 amendment changed the Item 105 disclosure standard from “the most significant factors” to “material” factors that make an investment risky. See COOLEY, SEC Adopts Amendments to Regulation S-K to Modernize Descriptions of Business, Legal Proceedings and Risk Factors (Oct. 2020), https://www.cooley.com/news/insight/2020/2020-10-05-sec-amendments-regulation-s-k-modernize-descriptions [https://perma.cc/2RRK-TGVG] (explaining 2020 amendment to Item 105). This change may further encourage EDSL. In 2021 the Supreme Court denied a petition for writ of certiorari seeking clarity with respect to the scope of disclosures required under Item 105. See M&T Bank Corp. v. Jaroslawicz, 141 S. Ct. 1284 (2021).


196. Id.


198. Langevoort, supra note 140, at 998.


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

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

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

\begin{footnotes}
\item[202] Langevoort, supra note 140, at 997.
\item[205] In re Lions Gate, 165 F. Supp. 3d at 9 (“A Wells Notice informs the recipient that the SEC Enforcement Division staff has decided to recommend that the Commission bring an enforcement proceeding, identifies alleged violations of securities law, and provides potential defendants the opportunity to make a responsive submission.”); see also David M.J. Rein & Jacob E. Cohen, Further Clarity on Duty to Disclose Wells Notices, LAW360 (Feb. 3, 2016, 10:06 AM), https://www.law360.com/articles/754295 [https://perma.cc/8G2N-CG8W] (discussing duty to disclose Wells Notices).
\item[206] See, e.g., Richman, 868 F. Supp. 2d at 274 (“At best, a Wells Notice indicates not litigation, but only the desire of the Enforcement staff to move forward, which it has no power to effectuate.”).
\end{footnotes}
regulator requests documents requests a tolling agreement, or decides not to close an investigation. Both the Department of Justice (DOJ) and SEC routinely request and receive tolling agreements, but such requests typically occur during investigative fact-finding, before an enforcement decision has been made.

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

In 2020 the SEC adopted amendments to Item 103 and certain other provisions of Reg S-K, which became effective in late 2020 and early 2021. Those amendments, while significant, failed to provide further

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


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

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


\textsuperscript{217} 17 C.F.R. § 229.10(a) (2021).

\textsuperscript{218} See 17 C.F.R. § 229.10(a) (2021).

\textsuperscript{219} Id. § 229.303(a).

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

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

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

223. Id.
224. Id.
226. Stratte-McClure, 776 F.3d at 103.
compliance. 228 Specifically, while regulatory investigations do not often trigger MD&A disclosure, plaintiffs frequently claim that Item 303 requires such disclosure if the company reasonably expects the investigation will have a material adverse effect. 229 Plaintiffs likely assert the claim to circumvent the fundamental securities rule that silence, absent a duty to disclose, is not misleading. 230

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

E. The PSLRA’s Safe Harbor

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

228. Benjamin, supra note 225.
229. Birnbach, supra note 215.
future performance, plans and objectives for future operations, and assumptions underlying these statements.\textsuperscript{236} The statute immunizes from liability any forward-looking statement provided that: (1) the statement is identified as such and is accompanied by meaningful cautionary language identifying important factors that could cause actual results to differ materially from those in the statement, or (2) the statement is immaterial, or (3) a plaintiff fails to show that defendant had actual knowledge that the statements were false or misleading when made.\textsuperscript{237} The immunizing language is disjunctive, so there is no liability with respect to statements covered by any of the three categories.\textsuperscript{238} Because the safe harbor incorporates an actual knowledge standard, a complaint may allege scienter as to a forward-looking statement only by alleging “knowing falsity.”\textsuperscript{239} Plaintiffs often seek to establish actual knowledge using information provided by confidential witnesses,\textsuperscript{240} who typically are defendants’ former employees.\textsuperscript{241}

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

\begin{itemize}
\item \textsuperscript{236} \textit{Id.} §§ 77z-2(i)(1), 78u-5(i)(1).
\item \textsuperscript{237} \textit{Id.} §§ 77z-2(c)(1), 78u-5(c)(1).
\item \textsuperscript{238} Wochos v. Tesla, Inc., 985 F.3d 1180, 1190 (9th Cir. 2021).
\item \textsuperscript{239} Slayton v. Am. Express Co., 604 F.3d 758, 773 (2d Cir. 2010).
\item \textsuperscript{241} See Gideon Mark, \textit{Confidential Witness Interviews in Securities Litigation}, 96 N.C. L. REV. 789, 790 (2018) (noting that CWs are defendant company’s current or former employees or, less frequently, customers or suppliers).
\item \textsuperscript{242} See Langevoort, \textit{supra} note 140, at 995.
\item \textsuperscript{244} See, \textit{e.g.}, Marilyn F. Johnson et al., \textit{The Impact of Securities Litigation Reform on the Disclosure of Forward-Looking Information by High Technology Firms}, 39 J. ACCT. RES. 297 (2001) (summarizing costs and benefits of PSLRA safe harbor).
\item \textsuperscript{245} See, \textit{e.g.}, \textit{In re} Bemis Co. Sec. Litig., 512 F. Supp. 3d 518, 537 n.6 (S.D.N.Y. 2021)
\end{itemize}
doctrine likely applies. Forward-looking statements often are aspirational\(^{246}\) and if they are deemed to be puffery they will be regarded as immaterial and likewise will be protected under the statutory harbor.

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

Separately or in combination, the harbor and doctrine often block EDSL plaintiffs, who primarily pursue two lines of attack. First, plaintiffs argue that the subject statements are not forward-looking, because certain elements or aspects relate to unprotected present or historical facts. Resolution of this argument can be difficult. The ultimate test is whether the truth or falsity of the statement depends on subsequent events,\(^{249}\) and this framework gives plaintiffs some ground on which to scrimmage. If a statement is linked to a future event, and its veracity cannot be determined until after this future event occurs, it generally finds a harbor.\(^{250}\) Six circuits have held that if a statement is mixed, the elements unrelated to the future receive no protection.\(^{251}\) The Ninth Circuit has taken an additional step and held that a materially false, non-forward-looking portion of a mixed statement generally precludes application of the safe harbor to the forward-looking portion.\(^{252}\) Other courts have agreed with the Ninth Circuit\(^{253}\) and the Supreme Court has declined to address the issue.\(^{254}\)


\(^{247}\) Langevoort, supra note 140, at 995.

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

\(^{249}\) Rosen & Carey, supra note 240, at 2.


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

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

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

F. The Role of Confidential Witnesses

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

256. See, e.g., In re Harman Int’l Indus. Inc. Sec. Litig., 791 F.3d 90, 102–03 (D.C. Cir. 2015) (explaining that cautionary language cannot be meaningful if it is misleading in light of historical facts).
260. See, e.g., In re Cabletron Sys., Inc., 311 F.3d 11, 30 (1st Cir. 2002) (observing that requiring plaintiffs to name their confidential internal corporate sources would have a chilling effect on employees who provide information about corporate malfeasance).
information alleged.261 Courts generally expect to see job descriptions and responsibilities, and often dates of employment and reporting lines.262

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

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

264. Id. § 78u-4(b)(2).
265. Pre-PSLRA, defendants in federal securities litigation were required to participate in discovery while motions to dismiss were pending. Defendants could avoid discovery only by moving for a protective order, requesting a stay, and showing good cause under Rule 26(c) of the Federal Rules of Civil Procedure. Such motions were usually denied. Gideon Mark, Federal Discovery Stays, 45 U. MICH. J.L. REFORM 405, 434 (2012).
268. In July 2021 the Supreme Court granted certiorari to decide whether the PSLRA’s discovery stay also applies in state court securities class actions based on federal law. State trial courts have sharply divided on this issue, even within such jurisdictions as California and New York, where most sections 11 and 12 claims are filed. See Pivotal Software, Inc. v. Superior Ct. of Cal., 141 S. Ct. 2884 (2021) (granting petition for certiorari); Andrew Clubok, Melissa Sherry & Gavin Masuda, Supreme Court’s Impending Decision Concerning Whether PSLRA Discovery Stay Applies in State Court, HARV. L. SCH. F. ON CORP. GOVERNANCE (July
rejected attempts to lift the stay on the ground that a defendant has already produced the documents in a government investigation, an internal investigation, a bankruptcy proceeding, or another action not governed by the PSLRA.\footnote{D\textsc{avid} M.J. \textsc{Rein}, M\textsc{atthew} A. \textsc{Schwartz} \& J\textsc{ohn} P. \textsc{Collins}, Jr., \textsc{Securities Litigation Involving the Private Securities Litigation Reform Act (PSLRA)} (2021), Thomas Reuters Practical Law W-010-6738.}

The PSLRA stay has major practical significance. The parties in securities class actions rarely file motions for summary judgment\footnote{See 2018 \textsc{Full-Year Review}, supra note 6, at 19 (“Motions for summary judgment were filed by defendants in 7.1\%, and by plaintiffs in only 1.9\%, of the securities class actions filed and resolved over the 2000–2018 period, among those we tracked.”).} and from 1997 to 2020 only 0.4\% of core federal securities filings (nineteen cases) advanced to trial.\footnote{2020 \textsc{Year in Review}, supra note 18, at 18.} Accordingly, the ultimate outcome of the litigation is primarily dependent on the resolution of motions to dismiss. If plaintiffs survive the motion, the likelihood of a substantial settlement—following almost inevitable class certification and not infrequent mediation—exponentially increases.\footnote{William S. Freeman \& Catherine T. Zeng, \textsc{The Trouble with ‘Confidential Witness’ Allegations}, \textsc{Law360} (Feb. 3, 2012, 2:12 PM), https://www.law360.com/articles/303826 [https://perma.cc/387H-FDPD]; accord \textsc{Containing the Contagion}, supra note 74, at 19 (“The district court’s decision on the motion to dismiss is the critical event in securities class actions: if the motion to dismiss is denied, class certification and settlement virtually always follow. . . .”).} Not surprisingly, then, motions to dismiss were filed in ninety-five percent of all securities class actions filed and resolved from 2000 to 2018.\footnote{2018 \textsc{Full-Year Review}, supra note 6, at 20.} These motions are almost always resolved absent discovery, because plaintiffs generally fail to have the automatic stay lifted under either of the two statutory exceptions.\footnote{Mark, supra note 241, at 795.} Approximately half of securities fraud class action complaints do survive motions to dismiss,\footnote{Gregory A. \textsc{Markel}, Giovanna A. \textsc{Ferrari} \& Heather E. \textsc{Murray}, \textsc{Defending Against Confidential Witness Allegations} (2021), Thomson Reuters Practical Law W-000-6239.} and almost all of them rely on confidential witnesses.

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

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

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

\begin{itemize}
\item \textsuperscript{276} See Union Asset Mgt. Holding AG v. SanDisk LLC, 227 F. Supp. 3d 1098, 1100 (N.D. Cal. 2017) (“The combined effect of the high scienter standard in securities fraud litigation and the strict PSLRA discovery stay is to place great weight at the pleading stage on the statements of confidential witnesses.”).
\item \textsuperscript{277} See, e.g., In re Bofi Holding, Inc., Sec. Litig., No. 15-CV-02324, 2016 WL 5390533, at *16 (S.D. Cal. Sept. 27, 2016) (“The Court is aware that confidential witnesses have become a staple of securities litigation.”).
\item \textsuperscript{280} Id.
\item \textsuperscript{281} See, e.g., Okla. Police Pension & Ret. Sys. V. Lifelock, Inc., 780 Fed. App’x 480, 484 n.5 (9th Cir. 2019) (noting that in securities class action based on defendants’ defective identity theft alerts, plaintiffs rely on CW who was Identity Alert Specialist); Schiro v. Cemex,
Massive job cuts stemming from the COVID-19 pandemic in 2020 are also likely to accelerate the use of CWs in EDSL. As noted above, the typical CW is a former employee. At the peak of the pandemic in 2020 more than 22 million jobs vanished in the United States and by February 2021 barely half of those jobs had been recovered. The large-scale layoffs by numerous companies greatly expanded the universe of former employees who might become CWs, and this expansion is likely to further catalyze plaintiffs’ use of such witnesses.

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

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

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


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


288. See Jeff G. Hammel & Elizabeth R. Marks, Confidential Witnesses: Reliable Source or Imaginary Friend?, 45 SEC. REG. & LAW REP., July 15, 2013 (discussing discovery issues).
Third, CW recantation, which is not rare, often requires the court to decide how to treat recanting statements in connection with a motion to dismiss and whether to reconsider the denial of such a motion if the recantation occurs after the initial ruling. Reconsideration is procedurally improper because it introduces extrinsic material at the pleading stage, but numerous courts have glossed over this point. Aligned recantation also requires courts to decide whether and when to impose sanctions under Rule 11 of the Federal Rules of Civil Procedure, which “should be reserved for egregious cases.” The foregoing issues are likely to arise even more often as EDSL becomes the norm.

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

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

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


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


297. In re BoFl Holding, Inc. Sec. Litig., 977 F.3d 781, 791–92 (9th Cir. 2020).
Ninth Circuit credited the whistleblower in light of his detailed and specific descriptions and firsthand knowledge—a test similar to that commonly used to evaluate information sourced from CWs. In so holding, the Ninth Circuit joined the Sixth Circuit in rejecting the categorical rule that allegations in another civil lawsuit, standing alone, can never qualify as a corrective disclosure. Rejection of such a rule may create a new path for EDSL plaintiffs to plead and prove scienter if information attributed to CWs is discounted, even though the Ninth Circuit’s discussion was confined to loss causation. The new avenue is to allege scienter based on prior whistleblower claims.

G. Loss Causation and Class Certification

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

1. Rebutting the Basic Presumption

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

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298. Id. at 792.
303. 485 U.S. at 247, 248 n.27.
requirement by invoking a presumption that the price of stock traded in an efficient market fully reflects all public material information. The fundamental premise underlying the fraud-on-the-market (FOTM) theory is that an investor presumptively relies on a misrepresentation that was reflected in the market price at the time of her transaction,\textsuperscript{304} even if the investor was unaware of the fraudulent conduct at the time of her purchase or sale.

The FOTM theory can establish the requisite transaction causation, but it does not establish the requisite loss causation, which is conceptually different. In order to establish loss causation plaintiff must show that after purchasing her shares and before selling, the following occurred: (1) the truth became known, and (2) the revelation caused the fraud-induced inflation in the stock’s price to be reduced or eliminated.\textsuperscript{305} The most direct way for plaintiffs to satisfy the requirement is to identify one or more corrective disclosures,\textsuperscript{306} which reveal the falsity of a previous representation to the market.\textsuperscript{307} In a FOTM case the plaintiff must show that the corrective disclosure was a substantial factor in causing a decline in the security’s price, thus creating an actual economic loss for the plaintiff.\textsuperscript{308} The disclosure need not precisely mirror the prior misrepresentation\textsuperscript{309} and it can be established by a series of cumulative, partial disclosures.\textsuperscript{310} What exactly constitutes a corrective disclosure for purposes of loss causation is an unresolved question. In general, however, a disclosure is not corrective if it contains information derived entirely from public sources of which the market was presumed to be aware.\textsuperscript{311} Corrective disclosures in EDSL often arise externally—for example, when a regulatory action is announced.\textsuperscript{312}

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

\textsuperscript{306} In re BofI Holding, Inc. Sec. Litig., 977 F.3d 781, 790 (9th Cir. 2020).
\textsuperscript{307} Id.
\textsuperscript{308} McCabe v. Ernst & Young, LLP, 494 F.3d 418, 425–26 (3d Cir. 2007).
\textsuperscript{310} Sapssov v. Health Mgmt. Assocs., Inc., 608 F. App’x 855, 862 (11th Cir. 2015).
\textsuperscript{311} Grigsby v. BofI Holding, Inc., 979 F.3d 1198, 1205 (9th Cir. 2020).
\textsuperscript{312} Lyle Roberts, Justices Should Clarify Securities Fraud Loss Causation, LAW360 (Apr. 29, 2021, 6:02 PM), https://www.law360.com/articles/1380152 [https://perma.cc/YA46-SDZC]. See also Richard A. Booth, What’s A Nice Company Like Goldman Sachs Doing in the Supreme Court? How Securities Fraud Class Actions Rip Off Ordinary Investors—And What to Do About It, 66 VILL. L. REV. TOLLE LEGE 71, 75 (2021) (observing that events can serve as corrective disclosures, even though the Supreme Court has never expressly so held).
materialization of an undisclosed or an under-disclosed risk that caused a stock price drop. The Circuits remain divided, but a majority of them to consider the issue have held that some form of risk materialization can suffice to show loss causation.313 Some courts have treated this as the equivalent of a corrective disclosure.314 The use of the risk materialization theory is especially common in EDSL, 315 and plaintiffs in event-driven cases have pursued both approaches simultaneously.316

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

To determine whether a security traded in an efficient market courts generally analyze a set of structural features commonly known as the Cammer319 and Krogman320 factors, which include both indirect indicia of

314. Id.
315. Elissa Mendoza & Jeff Lubin, Event Driven Securities Litigation, HARV. L. SCH. ON CORP. GOVERNANCE (Dec. 18, 2020), https://corpgov.law.harvard.edu/2020/12/18/event-driven-securities-litigation/ [https://perma.cc/ZGW4-U4HH] (“The main theory in the event-driven cases is that the occurrence or event upon which the case is based was the materialization of an under-disclosed or downplayed risk.”).
317. FED. R. CIV. P. 23(b)(1)–(3).
320. Krogman v. Sterritt, 202 F.R.D. 467, 474 (N.D. Tex. 2001). The three Krogman factors are the market capitalization of the company, the bid-ask spread of the stock, and the percentage of stock not held by insiders. Id.
efficiency such as high average weekly trading volume and direct empirical evidence demonstrating a cause and effect relationship between unexpected corporate events or financial releases and an immediate response in the stock price.\textsuperscript{321} The existence of a causal relationship is the fifth \textit{Cammer} factor, and it may be the most important one. However, if the remaining factors strongly support a presumption of market efficiency, courts can dispose of causation.\textsuperscript{322}

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

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

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\textsuperscript{321} In re Petrobras Sec. Litig., 862 F.3d 250, 276 (2d Cir. 2017).
\textsuperscript{322} In re Allergan PLC Sec. Litig., No. 18 Civ. 12089, 2021 WL 4077942, at *10 (S.D.N.Y. Sept. 8, 2021).
\textsuperscript{324} Fed. R. Civ. P. 23.
\textsuperscript{326} 569 U.S. 27, 34 (2013).
\end{flushright}
antitrust law, but the holding applies to class certification generally and in securities litigation specifically. Still, the case has sowed much confusion among the lower courts. The Fifth Circuit rejected a proposed class in EDSL arising from the 2010 Deepwater Horizon oil spill and premised on a risk materialization theory, because plaintiffs’ proposed damages model failed the Comcast test. In other EDSL, plaintiffs’ models satisfied Comcast, or the court certified a class after deciding that Comcast was inapposite. Third, the Supreme Court held in 2014 in Halliburton Co. v. Eric P. John Fund, Inc. (Halliburton II) that defendants are entitled to rebut the Basic presumption before a class is certified. This can be done by (1) showing a lack of reliance, (2) disproving the indirect indicia of efficiency, or (3) showing that the alleged misrepresentation did not actually impact the price of the security, and the same substantive evidence that is relevant to loss causation also may be relevant to reliance. Efforts to rebut the Basic presumption spell trouble for courts because the Cammer factors do not create bright lines. There are no clear benchmarks for how securities should perform with respect to each of them, and while in theory a test could disprove that a security traded in an efficient market, no single test—or any combination of tests—can prove that a security did trade in an efficient market. Still, it is defendants rather than plaintiffs who confront a steep uphill battle in this environment. The fraction of stocks deemed inefficient in class certification proceedings is less than 2% of all stocks for which a class certification has been decided by the courts. A

329. Ludlow v. BP, P.L.C., 800 F.3d 674, 689–91 (5th Cir. 2015).
330. See, e.g., Waggoner v. Barclays PLC, 875 F.3d 79 (2d Cir. 2017) (affirming certification in § 10(b) action against investment bank for allegedly providing secret advantages to high-frequency traders); In re Allergan PLC Sec. Litig., No. 18 Civ. 12089, 2021 WL 4077942, at *14–15 (S.D.N.Y. Sept. 8, 2021) (certifying class in pharmaceutical EDSL after rejecting argument premised on Comcast that plaintiffs’ damages model was inconsistent with liability theory).
333. In re Allstate Corp. Sec. Litig., 966 F.3d 595, 605–08 (7th Cir. 2020).
335. Id.
336. Assen Koev & Tiago Duarte-Silva, The Cammer Turnover Factor in Securities Class
separate analysis reported that certification motions were denied in only 1% of securities fraud class actions resolved from 2011–2020, and denials often involved unique facts “rather than reflecting consistently viable strategies for opposing class certification.”  

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

2. Goldman Sachs and the Inflation Maintenance Theory

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

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

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

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

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

345. See In re Finisar Corp. Sec. Litig., No. 11-cv-01252, 2019 WL 2247750, at *6 (N.D. Cal. May 24, 2019) (“Plaintiff has not previously and cannot now proceed on a price maintenance theory. . . .”).
348. In re Allstate Corp. Sec. Litig., 966 F.3d 595, 610 (7th Cir. 2020); Waggoner v. Barclays PLC, 875 F.3d 79, 103 (2d Cir. 2017).
Sachs that raised some of the key unresolved class certification issues discussed above. The litigation stemmed from a collateralized debt obligation (CDO) transaction that Goldman underwrote in 2007 that lost CDO investors $1 billion after the bank allegedly helped a client short the CDO while simultaneously selling it elsewhere. Goldman settled an SEC enforcement action concerning its conduct for $550 million in 2010. Plaintiffs in the securities litigation, who were Goldman shareholders, claimed that the bank’s corporate statements misrepresented the transaction as being conflict-free in order to maintain an artificially inflated stock price that was deflated when the SEC enforcement action revealed conflicts.

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

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

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

352. See id. at *18–19.
353. Id. at *34–35.
354. Id. at *36 (citing Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 345 (2005)).
It vacated the class certification and held that courts may consider the generic nature of alleged misrepresentations as evidence of the lack of price impact when defendants attempt to rebut Basic’s presumption of class-wide reliance at the class certification stage, even if the evidence overlaps with materiality or any other merits issue. This holding reconciled Halliburton II, which allows rebuttal by disproving price impact, with the earlier case of Amgen Inc. v. Connecticut Retirement Plans and Trust Funds, which held that plaintiffs are not required to prove materiality at the certification stage. The Court also held in Goldman Sachs that defendants seeking to rebut the presumption of reliance bear both the burden of production and the burden of persuasion to prove lack of price impact by a preponderance of the evidence, consistent with prior decisions in the Second and Seventh Circuits. Finally, in Goldman Sachs the Supreme Court recognized the inflation maintenance theory for the first time ever, but declined to address its merits. In a footnote it stated: “Although some Courts of Appeal have approved the inflation-maintenance theory, this Court has expressed no view on its validity or its contours. We need not and do not do so in this case.”

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

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358. Id. at *4 n.1.

359. Id. at *5–6.

lower courts more discretion to deny certification based on the entire record. \(36^1\) Just two days after the Supreme Court decided \textit{Goldman Sachs}, defendants in pending \#MeToo EDSL against CBS Corporation cited the case to oppose class certification on the basis that the misrepresentations at issue were too generic to establish price impact. \(36^2\)

Conversely, \textit{Goldman Sachs} made clear that the generic nature of defendants’ statements does not exclude them from consideration at the class certification stage. \(36^3\) The Supreme Court’s refusal to shift the burden of proving price impact also aids plaintiffs. The Court observed that “the allocation of the burden is unlikely to make much difference on the ground” \(36^4\)—and generally will become dispositive only in the rare case where the evidence is in equipoise, but plaintiffs can further enhance their chances of avoiding successful \textit{Basic} rebuttals if they rely less on generic misstatements. Alternatively, they can sidestep \textit{Basic} and undertake the herculean task of demonstrating direct reliance by showing they were aware of, and directly misled by, misrepresentations. \(36^5\)

Finally, \textit{Goldman Sachs} left intact for the foreseeable future the inflation maintenance theory, upon which much EDSL is premised. As Professor Coffee noted, in \textit{Goldman Sachs} “there is enough discussion of inflation maintenance that lower courts are likely to treat it as established doctrine until if and when the court reconsiders it.” \(36^6\) On remand from the

\begin{itemize}
  \item \(36^5\) See, e.g., Semerenko v. Cendant Corp., 223 F.3d 165, 178 (3d Cir. 2000) (observing that plaintiffs can prove direct reliance by establishing they were aware of, and directly misled by, an alleged misrepresentation).
\end{itemize}
Supreme Court to the Second Circuit, and subsequent remand to the district court, plaintiffs in Goldman Sachs continued to rely on the inflation maintenance theory, in opposition to defendants’ on-going bid to have the class decertified and not re-certified.\footnote{367}

III. SIX MAJOR EDSL CATEGORIES

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


airplane crashes, and apartment building fires.

A. COVID-19

By 2021 the COVID-19 pandemic had become the most recent significant source of EDSL. Counts vary as a function of methodology, but according to one reliable tally at least 40 coronavirus-related federal securities class actions were filed from March 2020–November 2021 and approximately 80% of them included Rule 10b-5 claims. At least twelve shareholder derivative actions stemming from the virus also were filed, and virtually all of them followed the commencement of securities class action litigation. The pandemic EDSL primarily but not exclusively comprises
three major case categories—those involving companies: (1) such as cruise
lines and private prison systems that sustained a virus outbreak in their
facilities, (2) such as vaccine manufacturers and diagnostic testing providers
that trumpeted their capacity to prosper as a result of the pandemic, and (3)
whose operations or financial results were impaired by pandemic-related
closures or lockdown orders. 378 Defendants likely will have the greatest
difficulty obtaining dismissals of cases in the second category, which targets
pharmaceutical businesses, including giant AstraZeneca 379 and penny stock
Vaxart. 380

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

378. See Kevin LaCroix, COVID-19 Securities Suits Continue to Accumulate, D&O
securities-suits-continue-to-accumulate/ [https://perma.cc/96GY-Q8QU] (describing case
categories).
379. See Rachel O’Brien, AstraZeneca Hit with Investor Suit over COVID-19 Vaccine,
a.cc/9BR5-6XS4] (discussing pandemic EDSL against AstraZeneca); WILMERHALE, COVID-
19: Lessons from the Second Wave of Securities Fraud Class Actions 9 (Oct. 28, 2020),
second-wave-of-securities-fraud-class-actions [https://perma.cc/U7BL-YEY5] (discussing
pandemic EDSL against pharmaceutical companies).
380. See Dorothy Atkins, Vaxart Buried Investors in ‘Avalanche of B.S.,’ Judge Says,
LAW360 (Sept. 30, 2021, 5:30 PM), https://www.law360.com/articles/1426908/vaxart-
buried-investors-in-avalanche-of-b-s-judge-says [https://perma.cc/R2R3-ZJGC] (reporting
on oral argument on motion to dismiss in EDSL involving Vaxart).
381. Dean Seal, Why a Surge of COVID-19 Securities Suits Hasn’t Happened, LAW360
/s://perma.cc/A58E-FTUP]; Robert Long, Elizabeth Clark & Alex Ingoglia, What to Expect
60.com/articles/1339565 [https://perma.cc/2YYC-VGFK] (noting inaccuracy of early
predictions concerning pandemic-related securities litigation).
382. See Dean Seal, The Next Wave of COVID-19 Securities Litigation Is Building,
LAW360 (Jan. 3, 2021, 12:02 PM), https://www.law360.com/articles/1338682/the-next-
significance of pandemic EDSL).
384. Joe Mont, Want to Change an SEC Rule? Petition the Commission, COMPLIANCE
The Chamber’s petition provided a broad but shallow critique of EDSL, noted the continued rise of pandemic EDSL, and then identified supposed defects in the PSLRA’s safe harbor provisions. The primary defects are that (1) various documents or transactions are expressly excluded from protection, including financial statements prepared according to generally accepted accounting principles, IPOs, and tender offers, and (2) the harbors are insufficient to deter the filing of meritless securities claims.\(^{385}\)

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

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

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

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386. *Id.* at 9–10.
387. *Id.* at 4.
388. McCabe v. Ernst & Young, L.L.P., 494 F.3d 418, 429 (3d Cir. 2007).
require revision, the Chamber provided virtually no support for this argument. Fourth, adoption of the proposed rule changes might encourage fraud, insofar as they overtly limit liability. Fifth, adoption would unwisely extend Omnicare to the contents of financial statements. Sixth, at least some of the proposed changes probably could—and should—only be accomplished legislatively. SEC rulemaking should not create a safe harbor for projections about the effect of the pandemic on operations and liquidity.

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

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

Market volatility during the pandemic’s early phase presents a rebuttal opportunity. From its historic peak of 3,338.16 on February 19, 2020 the S&P 500 Index lost 34% of its value in approximately one month as the potential consequences of COVID-19 began to be incorporated into share prices, but by July 31, 2020 the Index had largely reversed its sharp decline. This was the most dramatic quarter-to-quarter swing since 1932.

An analysis published in November 2020 concluded that Carnival’s common stock price drops on some of the alleged corrective disclosure dates

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390. 485 U.S. at 247, 248 n.27.
were “fully explained by market and industry factors.”

A second defense tool, related to the foregoing, is to argue an absence of loss causation based on an absence of price impact. Loss causation is a fact-based inquiry. If a market-wide event creates losses for most companies, and there is significant volatility—as in the early stages of the pandemic—it becomes increasingly more difficult for plaintiffs to prove causation. The 2007-08 financial crisis is instructive. Securities class action filings increased nearly 20% in 2008 and the crisis litigation continued for more than a decade, with loss causation a frequently disputed issue. Multiple defendants prevailed on this issue during motion practice because their stock drops at the time of alleged corrective disclosures tracked market sector declines.

The early stages of the pandemic caused the largest market decline since 2008 and defendants in COVID-19 cases should take some solace from the prior litigation. Defendants should be reassured even though the pandemic cases are fundamentally different than the prior litigation, which


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

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

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


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


of price impact or loss causation,\textsuperscript{405} but their constraints are magnified during
periods of extreme market volatility\textsuperscript{406} and thus proof may be difficult to
establish in COVID-19 EDSL. As noted supra, one event study determined
that Carnival’s common stock price drops at the time of corrective disclosure
tracked market sector declines.

Because Securities Act section 11 and section 12(a)(2) do not require
proof of scienter or loss causation,\textsuperscript{407} and such claims may be filed in state
court, the Securities Act may offer a more fruitful path for plaintiffs to pursue
pandemic EDSL. Section 11 provides a formula—constituting the exclusive
method for calculations\textsuperscript{408}—which provides that damages are generally
measured by the difference between the price of the offering and the price
on the date plaintiffs’ complaint was filed.\textsuperscript{409} Defendants have a potential
negative causation affirmative defense, which grants them the opportunity to
disprove that a stock drop was caused by an alleged misstatement or omission.\textsuperscript{410} The defense may be employed even in connection with a motion
to dismiss, when negative causation is apparent on the face of the
complaint.\textsuperscript{411} The defense is the mirror image of causation under section
10(b),\textsuperscript{412} so it may be as difficult for defendants to disprove causation under
the Securities Act as it will be for EDSL plaintiffs to prove causation under
the Exchange Act.\textsuperscript{413} In general, however, the dismissal rate for section 10(b)
cases involving already-public companies is significantly higher than it is for

\textsuperscript{405} See Dean Seal, As Investor Suits Tick Up, Loss Causation May Be a Hard Sell,

\textsuperscript{406} Michelle Levin & Ashwin Ram, Securities Enforcement Activity in the COVID Era:

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

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

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

\textsuperscript{410} See id. (setting forth defense).

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

(“Courts have recognized that the negative loss causation affirmative defense in the Section
11 context and the loss causation element of Section 10(b) claims are ‘mirror images.’

\textsuperscript{413} Scott A. Edelman et al., Securities Class Actions Arising from the COVID-19
sections 11 and 12 cases involving IPOs. Among securities cases filed from 2010–2019, the dismissal rate for the former is 56% and for the latter it is 39%.414

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

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

417. Id. at *9–10.
419. Id.
is a solution that works 100 percent” was a non-actionable statement of corporate optimism. 421 It is difficult to understand this characterization.

Forward-looking statements are protected by the PSLRA when future risks are addressed explicitly and specifically. The safe harbor protected some defendants in connection with securities litigation stemming from the 2008 financial crisis, 422 but other defendants were left unprotected, where the allegedly misleading disclosures were statements of present risk factors, rather than forward-looking predictions about future events. 423 Likewise, statements about a company’s present ability to handle COVID-19 may not be shielded by the safe harbor if they constitute a mix of present fact and future events, 424 and forward-looking statements are highly unlikely to be protected if the accompanying cautionary language is generic. 425 In February 2021 a federal district court handling consolidated pandemic EDSL in Pennsylvania against biotechnology firm Inovio Pharmaceuticals and its top executives mostly denied a motion to dismiss and mostly rejected application of the safe harbor because the subject statements or omissions were of present facts concerning defendants’ then-current capacity to manufacture vaccines. 426 Plaintiffs subsequently moved for class certification in July 2021. 427 Conversely, in Norwegian Cruise Line the court applied the safe harbor, even though defendants’ challenged statements related to historical and contemporaneous acts, because they rolled into forecasts of future action. 428 And in September 2021 a federal district court partially granted and partially denied a motion to dismiss in pandemic EDSL involving a private prison defendant, after determining that many of the subject statements were forward-looking, classic puffery—”generalized, vague,

421. Id. at 13.
422. See, e.g., Police Ret. Sys. of St. Louis v. Intuitive Surgical, Inc., 759 F.3d 1051 (9th Cir. 2014) (affirming dismissal of complaint with prejudice).
424. See, e.g., In re Quality Sys., Inc. Sec. Litig., 865 F.3d 1130, 1146–48 (9th Cir. 2017) (holding that mixed statements were actionable and reversing dismissal of action).
425. See, e.g., In re Bear Stearns Cos. Sec., Derivative & ERISA Litig., 763 F. Supp. 2d 423, 495 (S.D.N.Y. 2011) (holding that cautionary language was generic and denying motion to dismiss in part).
428. Id.
nonquantifiable statements of corporate optimism," or both.\textsuperscript{429}

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

Fifth, defendants can minimize potential damages under the PSLRA’s bounce-back provision, which caps damages at the difference between plaintiff’s purchase price and the mean trading price of the security during the ninety days following a corrective disclosure. If plaintiff sells before the ninety days, damages are capped at the difference between the purchase price and the mean trading price between the disclosure date and the sale date.\textsuperscript{433} The bounce-back provision was intended to limit a plaintiff’s damages to losses actually caused by the securities fraud or violation—as opposed to unrelated market conditions—by allowing the market to incorporate all relevant information and the stock price to adjust accordingly. The provision thus functions as a rescissory cap on out-of-pocket damages in securities litigation by affording the security an opportunity to recover.\textsuperscript{434} It can have a major impact on damages, especially when the stock price appreciates after the class period ends.

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

\textsuperscript{432} Order at 30-33, \textit{In re Carnival Corp. Sec. Litig.}, No. 1:20-cv-22202 (S.D. Fla. May 28, 2021).
\textsuperscript{433} 15 U.S.C. § 78u-4(e)(1)-(2).
\textsuperscript{434} \textit{In re Veritas Software Corp. Sec. Litig.}, 496 F.3d 962, 967 n.3 (9th Cir. 2007).
been adjudicated. In 2021 one of the few courts to ever apply the provision held in cybersecurity EDSL against Zoom that if there are multiple corrective disclosures there are multiple relevant look-back periods. Damages can be calculated based on an initial or a last partial corrective disclosure preceding the date that a specific plaintiff sold its shares, subject to the discretion of the court.

Such an approach has the potential to significantly favor defendants by sharply reducing settlement values. In some suits the bounce-back provision can eradicate available damages.

The bounce-back is somewhat inconsistent with Basic’s rationale, insofar as the implied premise that it requires 90 days for the market to incorporate all relevant information in incompatible with the notion of an efficient market. Nevertheless, the cap remains part of the PSLRA’s quarter-century legacy. The provision was rarely invoked and rarely applicable pre-COVID-19 but it could function as a key defense tool in pandemic EDSL. Defendants can use the bounce-back early in the litigation, because a court may take judicial notice of stock price movement without converting a motion to dismiss to a motion for summary judgment.

Many of the COVID securities cases began on porous ground, insofar as they were filed following modest stock price drops and/or proposed short class periods based on the proximity of the filings to the outbreak of the virus. The bounce-back provision could further minimize potential damages and settlement values in these and other pandemic actions.

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

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

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

445. Id.
446. Id.
Commission. Such suggestions are hyperbolic but not meritless. Pre-COVID very few companies made specific risk-factor disclosure concerning a pandemic’s potential impact on their business. Form 10-Q requires companies to disclose any material changes to the risk factors that were included in their Annual Report on Form 10-K. A review by Ernst & Young of Fortune 100 companies found that 90% included at least one new COVID-19 risk factor in their 10-Q filings between February 1 and May 31, 2020 and a separate review of the SEC filings by 3,644 publicly traded companies in the United States found that virtually every company (99.6%) made some level of pandemic disclosure by May 29, 2020. COVID-era disclosures encouraged by the SEC may be identified by plaintiffs as revealing prior material omissions or the disclosures may be characterized as misleading.

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


454. See Zelichov & Costley, supra note 374.


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

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

B. Cannabis

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

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with passage by Congress of the Agriculture Improvement Act of 2018\(^\text{463}\) (which decriminalized the cultivation of hemp), the legalization of adult-use recreational cannabis in Canada in 2018, \(^\text{464}\) and the accelerating legalization of medical and recreational cannabis products by individual states. By 2021 an estimated one in three Americans resided in a state with legalized recreational marijuana. \(^\text{465}\) The total economic impact from cannabis sales in the United States was projected to reach $92 billion in 2021 and spike to $160 billion in 2025. \(^\text{466}\) The confluence of these developments has spurred numerous CRBs—typically ancillary non-plant touching businesses—to sell shares on the NYSE and Nasdaq, and other corporations already listed on the U.S. exchanges have entered the industry. \(^\text{467}\)

The advent of publicly traded cannabis corporations has attracted the attention of the plaintiffs’ securities bar, which has filed an increasing number of lawsuits alleging violations of the federal securities laws following declines in the share price for the companies. Cannabis securities class action litigation commenced in 2014 \(^\text{468}\) and by March 2022 there had been at least 33 such filings. \(^\text{469}\) Twenty-three of them occurred during 2019–2021. \(^\text{470}\) This accelerating trend is expected to continue, driven in large part by industry growth, stock price volatility, \(^\text{471}\) regulatory uncertainty, \(^\text{472}\) and the


467. Gismondi & Michael, supra note 461.


470. Id.

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

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

The cannabis EDSL trend reflects the broader phenomenon of expanding securities class action litigation against life sciences companies. In 2017 and 2018 approximately 20% of securities class action suits were filed against life sciences companies and by 2019 this share had increased to approximately 25%.476 In 2019 the number of such actions filed against life sciences companies reached historic levels. Plaintiffs filed ninety-seven securities class action lawsuits against life sciences companies that year, and 9% of the actions were commenced against CRBs.477 Filings against life sciences companies declined to 80 in 2020, consistent with the overall pandemic-induced reduction that year, but still accounted for approximately 25% of all securities class action filings.478

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

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


477. Id.

478. Id.

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

480. Nicki Locker & Laurie B. Smilan, 2019 Life Sciences Securities Litigation Roundup,
shares aspects of litigation against other companies in the life sciences sector, insofar as the cases often focus on defendants’ communications with, and responses to actions by, the FDA.\footnote{590}

Most of the cannabis EDSL has been filed pursuant to section 10(b) and Rule 10b-5, but other actions have included section 11 claims. The complaints usually center on disclosures related to operations, transactions, financial guidance, financial restatements, and internal controls.\footnote{481} Many of them allege that the CRB made affirmative misrepresentations about earnings prospects, or knowingly failed to disclose the minimal demand for its products,\footnote{483} the full risk of regulatory hurdles,\footnote{484} and reductions in revenue.\footnote{485}

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

\footnote{590}{U. of Pennsylvania Journal of Business Law} [Vol. 24:3]


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

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

\footnote{486}{Gismondi & Michael, supra note 461.}

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

\footnote{488}{See, e.g., Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital, Inc., 531 F.3d 190, 196 (2d Cir. 2008) (holding that plaintiffs must specifically identify reports or
Tilray, Inc., the court granted a motion to dismiss in 2021 after observing that “scienter cannot simply be presumed from a defendant’s organizational role or professional expertise” and completely discounting allegations from a CW. Similarly, in litigation against Canopy Growth—the largest Canadian CRB—the federal district court dismissed plaintiffs’ second amended complaint in 2021 after discounting information provided by a CW and concluding that plaintiffs failed to adequately allege scienter.

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

The decision in *Sundial Growers* highlights another obstacle—common in post-IPO securities suits—confronted by cannabis plaintiffs in adequately alleging a material misrepresentation or omission. The decision concluded that the statements by defendant Sundial identified by plaintiff as false or misleading were corporate puffery, mere expressions of corporate optimism,
or statements of opinion. As noted supra, puffery encompasses statements that are too inexact to cause reasonable investors to rely upon them and therefore cannot have misled them. In general, federal appellate courts to consider the issue have held that puffery, puffing, or statements of corporate optimism are not actionable as a matter of law and securities claims based on such statements are subject to dismissal on a motion to dismiss. However, if puffery is both factual and material, it may be actionable.

In Sundial Growers the trial court concluded that such references in Sundial’s offering documents as “high quality” and “premium” cannabis were non-actionable puffery or opinions, and this decision was affirmed on appeal in 2021. However, in September 2020, a few months before the Sundial appellate decision was issued, securities litigation involving Canadian CRB Aphria produced a different result. Here the federal district court rejected an argument that references to an Aphria asset as “world class” or “established and successful” were non-actionable puffery or expressions of corporate optimism. According to the court, a reasonable investor could rely on such statements, when viewed in context, because they indicate that an asset is operational. Shortly thereafter Aphria announced that it was merging with Tilray to form the largest cannabis company in the world.

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

494. Id.
499. Id.
the latter, the court noted that HEXO’s cautionary language directly addressed the relevant risk that the company was operating within a newly legalized industry in Canada. The court also rejected plaintiffs’ arguments concerning Items 105 and 303. A few months later a New York state court judge also dismissed a proposed securities class action alleging a section 11 claim against HEXO, again in major part on the basis of the bespeaks caution doctrine. The court in Canopy Growth also concluded that most of the challenged statements by defendants were protected by the safe harbor. Finally, in September 2021 a federal court dismissed with prejudice section 10(b) and section 11 claims against Sundial Growers, in large part on the basis of the safe harbor.

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

C. Corruption

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

504. Id. at 302–03.
or other gifts to foreign officials and political actors with intent to influence or obtain or retain business.\textsuperscript{510}

Both the SEC and DOJ have enforcement authority (and the Commodity Futures Trading Commission (CFTC) recently began to assert authority),\textsuperscript{511} but there is no private right of action under the FCPA.\textsuperscript{512} The absence of a private right of action has spurred the filing of class actions alleging securities fraud, as an antidote. In general, plaintiffs can pursue such litigation if their allegations do not reflect an attempt to enforce the FCPA and instead are independently actionable under the Exchange Act.\textsuperscript{513} Other collateral civil actions, including shareholder derivative actions, commercial litigation, employment and whistleblower litigation, ERISA\textsuperscript{514} actions, RICO\textsuperscript{515} actions, and Alien Tort Claims Act\textsuperscript{516} litigation, also have followed in the wake of SEC and DOJ FCPA investigations and enforcement proceedings.\textsuperscript{517} Most of these other collateral actions have failed. For example, courts have routinely dismissed FCPA-related derivative actions, often for failure to meet the demand requirement imposed by many states, including Delaware and New York.\textsuperscript{518} The requirement obliges plaintiff, prior to suing derivatively, to ask the board of directors to sue on behalf of the corporation or plead demand futility with particularity in the derivative complaint.\textsuperscript{519}

\textsuperscript{510} 15 U.S.C. §§ 78dd-1(a), -2(a), -3(a).
\textsuperscript{512} See Gideon Mark, Private FCPA Enforcement, 49 AM. BUS. L.J. 419 (2012) (arguing in favor of recognition of a private right of action in FCPA cases).
\textsuperscript{516} 28 U.S.C. § 1350.
In standard EDSL, after a company has publicly disclosed potential FCPA violations and/or settled with the federal government, plaintiff shareholders file suit alleging that the company earlier fraudulently failed to disclose, or made false or misleading disclosures regarding, the nature and scope of the company’s FCPA violations or internal controls for detecting such violations. To adequately allege bribery plaintiffs must plead the “who, what, when, where, and how” of the alleged improper transaction.\(^{(520)}\) The complaints in these actions often rely on statements made by defendant in a deferred prosecution agreement (DPA) or settlement agreement with the SEC or DOJ, in which the company admits facts about misconduct and internal control failures and—in the case of DOJ involvement—avoids a criminal conviction.\(^{(521)}\)

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


\(^{(522)}\) Id.


The Petrobras and Cobalt settlements ranked fifth and forty-fourth, respectively, among the top 100 U.S. securities class action settlements of all-time, as of December 31, 2020,\(^526\) and likely have encouraged plaintiffs’ class action counsel to further pursue FCPA cases. For example, EDSL was commenced in August 2020 against Airbus after the aerospace giant earlier agreed to pay combined global penalties of more than $3.9 billion to resolve foreign bribery and export control charges. This was the largest global foreign bribery resolution by 2020.\(^527\) The complaint in the follow-on EDSL alleged that Airbus used bribery to obtain and retain aircraft, helicopter, and defense deals, and the company’s stock price dropped after regulatory investigations were disclosed and again as the scandal unfolded.\(^528\)

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

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\(^526\) Top 100 Settlements, supra note 8, at 6–10.


\(^531\) See, e.g., Doshi v. General Cable Corp., 386 F. Supp. 3d 815, 830 (E.D. Ky. 2019) (“The problem is that [defendant] never said it had an effective compliance program.”).
The second category is statements from SOX certifications or SEC filings concerning the existence or effectiveness of a company’s internal controls. SOX certifications do not make any explicit reassurances regarding the FCPA and general statements about internal controls are not actionable. But plaintiffs have been successful when the statements constitute an opinion about the effectiveness of the controls and the speaker was aware the opinion was false. This may be reflected in admissions by the company in settlement agreements with the SEC or DOJ or if the signing officers knew that an internal audit contradicted the certifications. Similarly, false or misleading statements by a company that it is in compliance with all applicable laws and regulations, and therefore it believes its controls are effective, may be actionable, rather than constituting puffery. Backward-looking statements regarding internal controls are unprotected by the safe harbor and bespeaks caution doctrine.

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

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536. In re Eletrobras Sec. Litig., 245 F. Supp. 3d 450, 468–69 (S.D.N.Y. 2017) (concluding that SOX certifications were indicative of scienter).
537. Villella v. Chem. & Mining Co. of Chile Inc., No. 15 Civ. 2106, 2017 WL 1169629, at *11 (S.D.N.Y. Mar. 28, 2017) (“The statements in the Annual Reports relay positive assurances that SQM believed it was in compliance with all applicable laws and regulations and that based on an evaluation, the CEO and CFO concluded that SQM’s controls were effective.”).
actionable, insofar as they place the source of revenue at issue.

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


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


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


547. Id. at *15.
parallel resolutions with the DOJ and SEC concerning FCPA violations.

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

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

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

552. Id. at *9.
bribes paid to members of the Ohio General Assembly. *FirstEnergy’s* facts are remarkably similar to *Exelon’s* facts. A criminal complaint preceding the securities litigation alleged that FirstEnergy bankrolled the 2018 election of Ohio Republican House Speaker Larry Householder, an effort by Householder to pass a $1.3 billion bill subsidizing two troubled FirstEnergy nuclear power plants, and a campaign to defeat a 2019 referendum to repeal the bill. Following the arrests of Householder and four others, FirstEnergy’s stock price plunged 45% and EDSL followed.553 A motion to dismiss a parallel civil RICO suit filed by ratepayers was denied in February 2021.554 Motions to dismiss the securities litigation were pending in July 2021, when FirstEnergy entered into a DPA and agreed to pay a $230 million penalty.555 Subsequently, in March 2022 the court mostly denied ten separate motions to dismiss filed by FirstEnergy and various officers, directors, and underwriters in the EDSL.556

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

558. See Linda Chiem, *Stellantis Inks $5M Deal to End Investor FCA-UAW Bribes Suit*,
Stellantis NV—formed by the merger of Fiat Chrysler and Peugeot parent Groupe PSA—agreed in 2021 to pay $5 million to settle the EDSL. 559

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

In a sixth example, in 2020 a federal district court applied the Basic presumption and certified a class of Novo Nordisk investors in EDSL alleging the global healthcare company misled shareholders about the source of its financial success while concealing a scheme to pay kickbacks to pharmacy benefit managers in exchange for access to the U.S. insulin market. 563 Certification followed denial of a motion to dismiss. In declining to dismiss the court rejected application of the PSLRA’s safe harbor because defendants’ cautionary language was inadequate. 564 The case settled for $100 million in September 2021. 565

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

559. Id.
D. Antitrust

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

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

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


568. Id.


Civil Procedure\textsuperscript{572} and falsity must be pled with particularity as to dual allegations that federal securities laws have been breached\textsuperscript{573} and defendant engaged in the underlying anticompetitive conduct.\textsuperscript{574} This conclusion also encompasses other kinds of underlying illegality,\textsuperscript{575} including foreign bribery. However, some courts have declined to resolve the issue\textsuperscript{576} or held that plaintiff must merely state a “plausible claim” that the underlying conduct occurred.\textsuperscript{577} A second issue is whether it suffices to plead scienter or loss causation for plaintiff to merely allege the existence of a government investigation—often by the DOJ—concerning anti-competitive conduct. In general, it does not suffice as to either element.\textsuperscript{578} A third issue concerns puffery and the impact of corporate codes of conduct.

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

\begin{itemize}
  \item \textsuperscript{572} Fed. R. Civ. P. 9. Rule 9(b) imposes a heightened pleading requirement of factual particularity with respect to fraud allegations.
  \item \textsuperscript{573} See, e.g., In re Tyson Foods Inc. Sec. Litig., 275 F. Supp. 3d 970, 996 (W.D. Ark. 2017) (applying PSLRA’s heightened pleading standards).
  \item \textsuperscript{574} See, e.g., Gamm v. Sanderson Farms, Inc., 944 F.3d 455, 465 (2d Cir. 2019) (“In practical terms, the pleading standard required appellants to have alleged the basic elements of an underlying antitrust conspiracy….”).
  \item \textsuperscript{576} See, e.g., In re Mylan N.V. Sec. Litig., No. 16-CV-7926, 2018 WL 1595985, at *15 n.11 (S.D.N.Y. Mar. 28, 2018) (declining to resolve the issue).
  \item \textsuperscript{578} See, e.g., DeLuca v. GPB Auto. Portfolio, LP, No. 19-cv-10498, 2020 WL 7343788, at *17 n.190 (S.D.N.Y. Dec. 12, 2020) (scienter); Lipow v. Net 1 UEPS Techs., Inc., 131 F. Supp. 3d 144, 167 (S.D.N.Y. 2015) (scienter); Lloyd v. CVB Fin. Corp., 811 F.3d 1200, 1203 (9th Cir. 2017) (reaffirming that announcement of investigation is insufficient to allege loss causation, unless investigation relates to an alleged misrepresentation and inaccuracy of misrepresentation is subsequently disclosed).
  \item \textsuperscript{579} Gamm v. Sanderson Farms, Inc., 944 F.3d 455, 458 (2d Cir. 2019).
\end{itemize}
plaintiffs, including restaurant chains and restaurant supply companies. In 2019 the DOJ revealed that it was investigating potential anticompetitive conduct in the industry and indictments followed in 2020. Some defendants in the antitrust actions are privately held companies, but many others are publicly traded. The shares of the public companies plunged early in the antitrust litigation and securities class actions followed. The poultry ESDL has fared poorly for plaintiffs, typically sinking in connection with the issues noted above. In one decision, issued in 2019, the Second Circuit affirmed the dismissal of an action against defendants Sanderson Farms, Inc. and its officers. The Second Circuit held that where a section 10(b) action is based on non-disclosure of illegal activity (such as price-fixing), the facts of the underlying activity must be pleaded with particularity under the PSLRA and Rule 9(b). In practical terms, this required plaintiffs to allege with particularity the elements of an antitrust conspiracy: (1) a contract, combination, or conspiracy; (2) in restraint of trade; (3) affecting interstate commerce. In this case, plaintiffs failed to satisfy their pleading burden. District courts in other poultry ESDL have similarly granted motions to dismiss because plaintiffs failed to plead with particularity the facts of the underlying antitrust violation.

581. Id.
586. Id. at 466–67.
Class actions alleging securities violations by companies in the generic drug industry that are the subject of DOJ and state price-fixing investigations and enforcement actions further illustrate key issues that arise in this category of EDSL. The generic drug market in the United States is huge—approximately 90% of prescriptions filled are for generic drugs, which are as safe and effective as their brand-name equivalents. The U.S. generic drug market was valued at approximately $130 billion in 2020 and the top five generic companies—measured by global market share—are Teva, Sandoz, Mylan, Pfizer, and Sun.

The DOJ began investigating the generic drug industry for anti-competitive conduct at least as early as November 2014, subpoenas were issued to several manufacturers and individual executives shortly thereafter, and by 2020 the DOJ had indicted five companies and multiple pharmaceutical industry executives. Most of the federal enforcement actions against defendant drug companies have been resolved with DPAs that spare the companies criminal convictions, while executives have typically entered dismissed plaintiffs’ second amended complaint in Pilgrim’s Pride, based on the statute of repose. Hogan v. Pilgrim’s Pride Corp., No. 16-cv-02611, 2021 WL 1534602 (D. Colo. Apr. 16, 2021). See also United Food and Commercial Workers Int’l Union Local 464A v. Pilgrim’s Pride Corp., No. 20-cv-01966-RM-MEH, 2022 WL 684169 (D. Colo. Mar. 8, 2022) (dismissing consolidated amended class action complaint with prejudice, in a similar case involving some of the same parties).


guilty pleas.\textsuperscript{595} The DOJ did not act alone. The Attorneys General of 20 states filed a civil action in 2016\textsuperscript{596} and subsequently filed two amended complaints alleging market allocation and price fixing in the generic drug market. The most recent amended complaint, filed in June 2020, identified 46 states, the District of Columbia, and four U.S. territories as plaintiffs and 26 companies and ten individuals as defendants. Whereas the DOJ criminal action encompassed a narrow subset of generic drugs,\textsuperscript{597} the civil action was expansive. The amended complaint by the Attorneys General added 80 additional generic drugs to the existing lengthy list of pharmaceuticals—including those used to treat HIV, cancer, and depression—for which most of the industry was accused of fixing prices.\textsuperscript{598} The litigation to some extent modeled prior tobacco and opioid cases and has been described as targeting “most likely the largest cartel in the history of the United States.”\textsuperscript{599} The litigation is proceeding as an MDL that also includes private plaintiffs.\textsuperscript{600}

Share prices of the pharmaceutical companies receiving DOJ subpoenas sharply declined and securities class actions followed, beginning in 2016.\textsuperscript{601} The complaints in the EDSL often allege that during the class period defendants artificially inflated their share price by falsely attributing their excellent financial results to astute business strategies rather than collusive increases in generic drug prices.\textsuperscript{602}

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


\textsuperscript{602} See, e.g., Ontario Teachers’ Pension Plan Board v. Teva Pharm. Indus. Ltd., 432 F. Supp. 3d 131, 143 (D. Conn. 2019):
Plaintiffs have fared significantly better in this line of EDSL than in the poultry cases. Some of the litigation settled early. Numerous other cases proceeded after denials of motions to dismiss and some classes were certified. In March 2021 the federal district court in Connecticut certified a class of investors in Teva Pharmaceuticals in antitrust EDSL. Teva also is a defendant in the state antitrust litigation and its U.S. subsidiary was criminally charged in August 2020 by the DOJ for conduct relating to its alleged collusion to fix certain generic drug prices. Plaintiffs in the certified class allege that Teva was able to leverage its stock price, inflated by its collusive behavior, to help finance a $40 billion purchase in 2016 of Actavis, which is the worldwide generics business of Allergan.

Prior to certification the court largely denied defendants’ motion to dismiss. The court determined that Teva, incorporated in Israel, failed to comply with Item 5 of SEC Form 20-F (which is applicable to certain foreign private issuers and requires the same disclosures as Item 303) by failing to disclose the price-based nature of its profits. The court also rejected arguments that (1) Teva’s statements were forward-looking, insofar as they discussed past performance but omitted pricing as a profit factor, and (2) mere puffery, insofar as statements that the company faced “fierce competition” were actionable, given the collusive nature of the generic drug market. However, the court rejected the argument that Teva was obligated to disclose two subpoenas from the DOJ and Connecticut Attorney General, because federal securities laws do not require disclosure of uncharged, unadjudicated misconduct, and the case subsequently settled for $420 million in January 2022.

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


605. Id. at *2.


607. Id. at 166.

608. Id. at 167; Order Preliminarily Approving Settlement and Providing for Class Notice, In re Teva Sec. Litig., No. 3:17-cv-00558 (SRU) (Jan. 27, 2022).
The federal district court in New Jersey denied a motion to dismiss the second amended complaint in a different securities class action that named as defendants Allergan, six of its top executives, and the board of directors. The amended complaint alleged that Allergan conspired to increase the prices of six generic drugs—some by as much as 7,000%—and made materially false statements or omissions about the conspiracy. In resolving the motion to dismiss the court first determined that plaintiffs plausibly alleged that Allergan participated in a price-fixing conspiracy. The court so held without applying a stricter standard requiring specificity in pleading the underlying anticompetitive conduct.

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

610. Id. at *6–9.
611. Id. at *6.
612. Id. at *7–11.
613. Id.
614. See, e.g., Steiner v. MedQuist, Inc., No. 04-5487, 2006 WL 2827740, at *16 (D.N.J. Sept. 29, 2006) (holding that statements attributing revenues to legitimate business factors such as increased sales were misleading because they failed to disclose defendants’ illicit billing scheme).
In July 2021 Allergan settled for $130 million while the investors’ motion for class certification was pending.\textsuperscript{617} This was the first such deal struck in the generic drug price-fixing EDSL,\textsuperscript{618} and it likely constituted a harbinger of future outcomes in other such cases. To date, federal district court decisions in at least four other actions in the generic drug EDSL have been mostly favorable to plaintiffs, and additional settlements would be unsurprising.

First, in litigation against generic manufacturer Taro, the court largely denied the motion to dismiss, after crediting information supplied by CWs and holding that Taro had placed the source of its profitability at issue without disclosing the underlying collusion.\textsuperscript{619} Second, in litigation against Mylan and several of its officers, the court rejected plaintiffs’ argument that the company’s Code of Conduct and Business Ethics—which stated that Mylan was committed to complying with applicable antitrust and fair competition laws—was materially misleading for failing to disclose the company’s anticompetitive conduct.\textsuperscript{620} The court categorized this statement as non-actionable puffery.\textsuperscript{621} However, the court also held that Mylan’s statements about its net income and revenue were materially misleading insofar as such metrics were inflated by virtue of its anticompetitive activity,\textsuperscript{622} and it found information supplied by a CW adequate to support an allegation of scienter as to price-fixing.\textsuperscript{623} The court later certified an investor class in 2020.\textsuperscript{624}

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

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

\textsuperscript{618} Id.


\textsuperscript{620} In re Mylan N.V. Sec. Litig., No. 16-CV-7926, 2018 WL 4572987, at *6–7 (S.D.N.Y. Sept. 24, 2018).

\textsuperscript{621} Id.

\textsuperscript{622} Id. at *6.

\textsuperscript{623} Id. at *17.

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

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

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

626. Id.


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


court also rejected defendants’ arguments that their statements were mere puffery and the core operations inference was inapplicable. In the third decision, issued in August 2021, the court certified the class.

To date, the generic drug EDSL has produced a single appellate decision, which was favorable to plaintiffs. In a pair of lower court decisions in securities litigation against generic drug manufacturer Impax Laboratories the Northern District of California granted motions to dismiss, ultimately with prejudice. In the first decision the court rejected application of the core operations inference, because the complaint failed to allege that defendant executives knew of the alleged collusion. In the second decision, issued after plaintiffs filed a second amended complaint, the court deemed plaintiff’s loss causation allegations insufficient as to price-fixing, because neither the issuance of a DOJ subpoena for four generic medications nor the disclosure of an investigation constituted the requisite corrective disclosures linked to stock price declines. But on appeal the Ninth Circuit reversed in part, in 2021, holding that plaintiffs had adequately pleaded loss causation as to their price-fixing theory. The litigation subsequently settled for $33 million.

What conclusions can be drawn from the antitrust EDSL? First, one of the primary obstacles for plaintiffs in these cases is the requirement to prove an antitrust conspiracy—a case within a case. If plaintiffs must plead with particularity the underlying collusive conduct this may be outcome-determinative for motions to dismiss. Second, there has been non-uniform application by courts of the core operations doctrine, likely because its contours are poorly defined. Third, successful use by plaintiffs of CWs to allege scienter can hinge on whether courts accept the proposition that information supplied by such witnesses should always be deeply discounted. Fourth, a fruitful falsity theory is likely to be that defendants placed the source of their profitability at issue without disclosing the underlying

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collusion. Fifth, it does not suffice to plead scienter for plaintiffs to merely allege the existence of a government investigation concerning anti-competitive conduct, and the disclosure of such investigations does not establish loss causation. Sixth, plaintiffs are likely to prevail on the puffery argument if defendants’ statements directly conflict with the collusive nature of the product market.

E. #MeToo

The #MeToo movement simultaneously has had a major impact on corporate America and has constituted another EDSL catalyst.\textsuperscript{637} The movement began on a limited basis in 2007\textsuperscript{638} but did not become prominent until 2017, when sexual assault allegations against entertainment mogul Harvey Weinstein surfaced. Even before the movement coalesced, shareholders pursued occasional derivative and securities fraud class actions in response to sexual harassment scandals. These pioneering actions—commencing in 1998 with a derivative suit involving ICN Pharmaceuticals\textsuperscript{639} and continuing with both derivative and class action litigation involving Hewlett-Packard in 2012—failed.\textsuperscript{640}

The #MeToo movement and recent scandals in a spectrum of industries have sparked a new, somewhat more successful generation of litigation\textsuperscript{641} that constitutes a significant subset of EDSL. In 2019, at least ten new actions asserting securities law claims based on corporate sexual misconduct were commenced, consistent with both the rate of filings in 2018 and 2017\textsuperscript{642}

\begin{footnotes}


\end{footnotes}
and predictions made when the #MeToo movement began in earnest. Additional actions began in subsequent years. For example, the S&P 500 video gaming giant, Activision Blizzard (responsible for Call of Duty, World of Warcraft, and Candy Crush), and three of its top executives were targets of #MeToo EDSL that kicked off in August 2021 after news about alleged pervasive sexual discrimination and harassment at the company surfaced and its share price dropped 6%. The foregoing judicial developments have taken place in tandem with legislative activity. Since 2017, at least fifteen states have passed new laws protecting against workplace sexual harassment.

EDSL in the #MeToo sector typically concerns public statements issued by a corporation—often in codes of conduct—with respect to company values, integrity, and adherence to ethical standards, compared with directors’ and officers’ alleged knowledge of behavior and practices within the company that undercut such policies. The complaints often allege that subsequent disclosure of the true facts led to a stock price decline and harmed investors. Alternatively, the complaints allege that the company engaged in a cover-up of the abuse, failed to take adequate steps to address it, or failed to truthfully disclose what steps it did or did not take to deter, investigate, or curb the problem after allegations of abuse became public.

In contrast, the derivative actions generally allege that the company’s directors and officers breached their fiduciary duties or wasted corporate assets when they ignored the hostile work environment caused by sexual harassment, failed to remedy the situation, and then incurred subsequent severance and settlement payments and litigation costs. Derivative actions based on #MeToo misconduct have been filed against Google’s parent company Alphabet, CBS, Liberty Tax, Lululemon Athletica, McDonald’s, National Beverage, Nike, Twenty-First Century Fox, Victoria’s Secret parent company L Brands, and Wynn Resorts, among others.


derivative action involving Alphabet settled in 2020 for a nominal $310 million—which in dollar terms was the largest-ever shareholder derivative settlement, the derivative action against L Brands settled in 2021 for a nominal $90 million, and the derivative action against Fox settled in 2017 for $90 million.

In multiple instances dual class and derivative actions have been filed against the same company based on overlapping #MeToo factual allegations, consistent with a recent pattern in securities litigation. In 2020, 55% of settled securities class actions involved an accompanying derivative action. The #MeToo derivative settlements also reflect another recent trend in derivative litigation overall—beginning in the mid-2010s—in which settlements include a significant cash payment. Historically, such settlements only encompassed defendant’s agreement to adopt certain governance reforms and to pay plaintiffs’ attorneys’ fees. Now such settlements often include those features as well as a major cash payment. In *L Brands*, for example, defendant agreed in July 2021 to adopt multiple management and governance reforms—including supplementation of its existing code of conduct with standalone policies on sexual harassment—

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and to fund these reforms with $90 million over the course of at least five years.\textsuperscript{653}

Not coincidentally, the number of public companies mentioning “sexual harassment” in risk factor disclosures also has spiked in recent years, despite the absence of any specific securities law requirement to disclose internal sexual harassment investigations. More than half of such disclosures in the last two decades (approximately 60 of 117) appeared after 2017.\textsuperscript{654} Companies make such non-mandatory disclosures for multiple practical reasons, including a desire to preemptively shape the narrative about the alleged abusive conduct.\textsuperscript{655}

The disclosure rules most likely applicable to sexual harassment investigations include Items 103 and 303, but even these provisions may have little significance. Item 103 requires disclosure of both material legal proceedings currently pending against a company and any such proceedings known to be contemplated by governmental authorities, but it does not specifically require disclosure of internal sexual misconduct investigations.\textsuperscript{656} Moreover, no disclosure is required if there is a proceeding involving primarily a claim for damages but the amount involved does not exceed 10% of the current assets of the company and its subsidiaries.\textsuperscript{657} An aggregation rule requires companies to count toward the 10% threshold all proceedings that present in large degree the same legal and factual issues,\textsuperscript{658} but very few #MeToo cases will involve damage claims that exceed the 10% threshold, even if aggregated.\textsuperscript{659}

Item 303 requires disclosure of known trends and uncertainties that have had or that the company reasonably expects will have a material favorable or unfavorable impact on net sales or revenues from continuing

\textsuperscript{653} Stipulation and Agreement of Settlement, Rudi v. Wexner, No. 20-cv-3068 (S.D. Ohio filed July 30, 2021).

\textsuperscript{654} A Year Later, supra note 642.


\textsuperscript{656} Spencer Feldman, Securities Law Blog Reporting Sexual Misconduct Allegations May Not Be Ready for SEC Disclosure Yet but Should Be Part of the Conversation, OLSHAN (Dec. 12, 2017), https://www.olshanlaw.com/pp/blogpost-reporting-sexual-misconduct-allegations-may-not-be.pdf?79491 [https://perma.cc/V9KE-L9YS] (observing that adverse investigatory findings concerning sexual misconduct “neither rise to the level of pending legal proceedings for purposes of Item 103, nor are they deemed to constitute the initial stage of pending legal proceedings”).

\textsuperscript{657} 17 C.F.R. § 229.103(b)(2) (2021).

\textsuperscript{658} Id.

\textsuperscript{659} Hemel & Lund, supra note 231, at 1650–51.
Allegations of sexual harassment against a CEO or other top executive may have such an effect and thus be subject to mandatory disclosure. This conclusion is suggested by research demonstrating that sexual harassment leads to lower productivity and higher rates of employee absenteeism and turnover, as well as by the potential litigation costs stemming from #MeToo claims.

One analysis, published in 2018, concluded that “the viability of securities law claims against companies that fail to disclose the extent of corporate sexual misconduct will be case specific,” and plaintiffs are likely to fare best in those cases in which defendants have made inaccurate specific statements about ongoing litigation. With the benefit of hindsight we can assess the accuracy of that conclusion by examining how plaintiffs fared in #MeToo EDSL from 2018–2020.

The results have been decidedly mixed, with decisions rendered in separate putative class actions involving defendants CBS, Liberty Tax, National Beverage, Papa John’s, Signet Jewelers, Uber, and Wynn Resorts. Plaintiffs achieved their greatest success in the Signet litigation, which settled for $240 million in 2020 after the federal district court denied defendants’ motion to dismiss the fifth amended complaint and motion for judgment on the pleadings, and then certified an investor class. Signet sought leave to appeal to the Second Circuit in an effort to obtain a Cigna-esque ruling, and the Second Circuit granted leave, but the appeal was withdrawn following a successful mediation. As of December 31, 2020, the Signet settlement ranked among the top seventy-five securities class action settlements of all-time.

The primary issue presented by the motion for judgment on the pleadings was whether statements in Signet’s Code of Conduct and Code of

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661. Birnbach, Fay & Schweers, supra note 655.
663. Id. at 1654–55.
668. Signet Settlement, supra note 664.
Ethics constituted non-actionable puffery and were therefore immaterial as a matter of law, pursuant to the decision in *Cigna*, which had been issued by the Second Circuit a few months earlier. The federal district court firmly rejected Signet’s argument, stating:

*Cigna* did not purport to change the well-established law regarding materiality. It did not announce a new legal rule, let alone one deeming an entire category of statements — those contained in a company’s code of conduct — *per se* inactionable. . . . Significantly, *Cigna* did not rule (as Defendants imply) that all statements in codes of conduct qualify as ‘puffery.’

The district court concluded that context matters, consistent with the Supreme Court’s decisions in *TSC Industries, Inc. v. Northway, Inc.* and *Basic Inc. v. Levinson*. And in *Signet*, the facts starkly differed from those alleged in *Cigna*. The statements in Cigna’s Code of Conduct were not actionable because they were exceptionally vague and aspirational. In sharp contrast, in the face of credible allegations (in a prior lawsuit) that Signet suffered from rampant sexual harassment, the company sought to reassure the investing public that it did not operate a toxic workplace. It did so by, *inter alia*, including representations in its periodic SEC filings that it expressly denied the allegations in the prior litigation and by falsely affirming its fidelity to internal policies which committed the company to making hiring decisions solely on the basis of merit, disciplining misconduct in its ranks, and providing employees with a means to report sexual harassment without fear of reprisal. As the court previously noted when it denied defendants’ motion to dismiss the fifth amended complaint, “statements contained in a code of conduct are actionable where they are directly at odds with the conduct alleged in a complaint.” When the court denied the motion to dismiss it likewise found that plaintiff adequately alleged that defendants made materially false or misleading statements in violation of Item 103, insofar as the public disclosures made by Signet mischaracterized the prior litigation, which alleged pervasive sexual harassment that reached the highest offices in the company.

Plaintiffs also experienced some success in the #MeToo EDSL involving defendant CBS. In 2020 the federal district court denied in part

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673. Id. at 231.
675. Id.
and granted in part a motion to dismiss the amended complaint in that case, which concerned alleged sexual misconduct by former CBS CEO and Chairman of the Board, Les Moonves.676 The court acknowledged that “it is not the case that all statements in a code of conduct are categorically immaterial puffery.”677 It then identified three situations in which courts allowed statements in a code of conduct to survive a motion to dismiss: (1) a company wielded its code to reassure investors that nothing was amiss when faced with suspicions of internal malfeasance, (2) statements in the code were sufficiently detailed and concrete that a reasonable investor could rely upon them, and (3) the code included statements that were so anathema to the alleged internal wrongdoing that, even if general or aspirational, they were materially false.678

The CBS court then distinguished Signet and held that most of the statements in CBS’s Business Conduct Statement (BCS) were mere puffery, because they were far too general and aspirational to invite reasonable reliance, and none were alleged to be false or misleading.679 The same was true with respect to statements in CBS’s Code of Ethics.680 This holding is dubious, because the court concluded that even such factual BCS statements as CBS “will . . . take all steps” [and] “remedial action” [to stop] “sexual harassment” were too general and disconnected from plaintiffs’ central theory of securities fraud to be material.681 According to the court, no reasonable investor would rely on these statements.682 It is not obvious that this is correct.

The court also rejected plaintiffs’ argument that Item 303 imposed on CBS an affirmative duty to disclose its executives’ sexual misconduct. Item 303 requires disclosure where a trend, demand, commitment, event, or uncertainty is both (1) presently known to management and (2) reasonably likely to have material effects on the registrant’s financial conditions or results of operations.683 Disclosure is required only with respect to those trends and other topics that the registrant actually knows of when it files the relevant report with the SEC.684 Item 303 disclosures most often relate to micro- and macroeconomic issues, such as erosion of the registrant’s market

677. Id. at *7.
678. Id.
679. Id. at *8–9.
680. Id. at *10.
681. Id.
682. Id.
In *CBS* the court rejected both defendants’ argument that information about workplace sexual misconduct is categorically exempt from disclosure under Item 303 and plaintiffs’ argument that Item 303 requires disclosure of foreseeable events, such as the negative impact on CBS’s earnings or revenues caused by the departure of Moonves. Defendants’ argument was misplaced because Item 303 is intentionally general, and plaintiffs’ argument was misplaced because Item 303 only requires disclosure of uncertainties that are more than foreseeable or possible. The court concluded that CBS had no duty to disclose either the company’s alleged hostile culture toward women or the percolating #MeToo accusations against Moonves, because the amended complaint did not allege that the uncertain futures of Moonves and other executives were reasonably likely to have an impact on the company’s financial performance.

So how did the amended complaint in *CBS* survive? The court allowed the action to proceed based on a statement by Moonves at a major industry event that “[#MeToo] is a watershed moment. . . . It’s important that a company’s culture will not allow for this. And that’s the thing that’s far-reaching. There’s a lot we’re learning. There’s a lot we didn’t know.” The court held that plaintiffs adequately alleged that this was a misleading statement of material fact, and the statement could be imputed to CBS. In effect, the amended complaint was saved by an allegation suggesting that Moonves was deceptively trying to cover-up his own misconduct. In 2020 plaintiffs moved for class certification, and that motion was pending in 2021.

Plaintiffs barely survived the motion to dismiss in *CBS*, but in numerous event-driven cases saving even one claim is plaintiffs’ primary objective. Once the case proceeds beyond this juncture settlement odds dramatically shorten. However, apart from *Signet* and *CBS*, plaintiffs have fared poorly in #MeToo EDSL since 2018. Dismissals were granted (and sometimes affirmed) in separate cases involving defendants Liberty Tax, National

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686. *Id.* at *15.  
687. *Id.*  
688. *Id.*  
689. *Id.* at *13.  
690. *Id.*  
Beverage,693 Papa John’s,694 Uber,695 and Wynn Resorts,696 although leave to amend was generally allowed.

Most of the foregoing decisions rejected as puffery those non-specific or aspirational statements about corporate culture or representations set forth in corporate codes of conduct, codes of ethics, or earnings calls. This was true in Liberty Tax,697 Papa John’s,698 and Wynn Resorts.699 In Papa John’s, the federal district court held that the “statements in the Code are quintessential puffery, ... rejected plaintiffs’ Item 303 argument because the #MeToo risk was not a risk known to management,701 and dismissed the first amended complaint. Leave to amend was granted, but in 2021 the court dismissed the second amended complaint—this time with prejudice—on the same grounds as before.702

In Wynn Resorts the federal district court in Nevada granted defendants’ motion to dismiss the first amended complaint. The court held that statements in the company’s Code of Conduct were merely aspirational and, citing the Ninth Circuit, stated that “investors do not rely on puffery when making investment decisions.”703 Again, it is not clear that this latter point is always true. Indeed, contrary empirical evidence suggests that investors do not ignore vague optimism when making investment decisions.704 In any event, the court granted leave to amend, and in July 2021 a different federal judge granted in part and denied in part defendants’ motion to dismiss plaintiffs’ second amended complaint. The court held that “[a]spirational statements in a code of conduct are not misleading,”705 but it found that two specific statements not set forth in the code were actionable. One was the statement by defendant Stephen Wynn that “[t]he idea that I ever assaulted

697. 828 Fed. App’x at 750–51.
698. 444 F. Supp. 3d at 560.
700. 462 F. Supp. 3d at 1120–22.
701. Id. at 564.
703. 462 F. Supp. 3d at 1120 (citing In re Cutera Sec. Litig., 610 F.3d 1103, 1111 (9th Cir. 2010)).
any woman is preposterous,” made in response to a Wall Street Journal article revealing allegations about his sexual misconduct. As to loss causation, the court, inter alia, found to be persuasive cases accepting the inflation maintenance theory, in the absence of guidance from the Ninth Circuit.

In the meantime, the parallel Wynn Resorts #MeToo derivative action settled for a cash payment of $41 million, plus corporate therapeutics and governance reforms that plaintiffs’ expert valued at an additional $49 million. In addition, Wynn Resorts was fined $55 million for covering up or ignoring the sexual abuse allegations against Wynn, its former CEO, following investigations by the Nevada Gaming Control Board and the Massachusetts Gaming Commission.

Sexual harassment is pervasive in the workplace. Claims against directors and officers arising from such misconduct can expose their employers to EDSL, as well as to massive costs encompassing reputational harm, consumer boycotts, declines in market capitalization, loss of corporate opportunities, and legal expenses for internal investigations, regulatory proceedings, and employment litigation.

What are the lessons of #MeToo EDSL to date? Primarily, it is difficult for a complaint to survive in these cases. Most of the allegations concerning codes of conduct and ethics will be treated as mere puffery and the outcome will often turn on whether the subject statements are specific misrepresentations, rather than vague and aspirational commentary. Items 101 and 303 are unlikely to be helpful to plaintiffs.

Still, the litigation and the #MeToo movement have spurred fundamental changes in corporate conduct. As noted, disclosures regarding sexual harassment have become significantly more common. In the M&A environment, representations in transaction documents that no harassment or
assault allegations have been made against the acquired company’s senior employees also have proliferated.\textsuperscript{712} From 2017–2020, the number of S&P 1500 corporations with all-male boards of directors dipped from 179 to 30, and by 2020 no S&P 500 company retained an all-male board.\textsuperscript{713} Employment agreements for CEOs of S&P 1500 companies increasingly include termination provisions that identify sexual harassment and discrimination as grounds for cause.\textsuperscript{714} And the #MeToo movement has been described as “stunningly effective in removing perpetrators from positions of power.”\textsuperscript{715}

The massive settlement in \textit{Signet} may serve to attract additional litigation in this sector, but potential #MeToo EDSL plaintiffs should be cognizant that the magnitude of the \textit{Signet} settlement was in large part a function of the compelling allegations of misrepresentations and omissions concerning losses in Signet’s in-house jewelry customer lending program that accompanied the #MeToo allegations.\textsuperscript{716} #MeToo securities class actions not involving accounting or financial fraud are unlikely to yield a \textit{Signet}-size settlement. Finally, it is important to underscore that derivative suits stemming from #MeToo allegations also have produced multiple plaintiff-friendly outcomes.\textsuperscript{717}

\subsection*{F. Cybersecurity}

The final category of EDSL analyzed herein concerns cybersecurity. In 2021 the World Economic Forum identified cybersecurity failure as a top “clear and present danger” and critical global threat.\textsuperscript{718} Cyber threats are

\begin{itemize}
\item \textsuperscript{712} A Year Later, supra note 642.
\item \textsuperscript{715} Jessica A. Clarke, \textit{The Rules of #MeToo}, 2019 U. Chi. Legal F. 37, 46.
\item \textsuperscript{717} Id.
\item \textsuperscript{718} \textit{World Economic Forum, Global Risks Report} 2021, at 11 (16th ed. 2021),
\end{itemize}
increasing in both scope and frequency, in part because the COVID-19 pandemic generated an abrupt transition to fully remote work for many companies. A second survey identified 1,108 data compromises in 2020, up from 785 in 2015 but down from 1,632 in 2019. A third survey identified 846 compromises in the first half of 2021, which projected to an annualized total that would be the largest during the period 2015–2021.

More than a quarter of companies that have been victimized by cyberattacks have been victimized more than once, and by 2020 five large companies had experienced seven or more cyberattacks—Facebook, Sony, Amazon, Comcast, and T-Mobile. Indeed, large companies with a market capitalization of at least $10 billion were most at risk for a cyberattack during the period 2011–2021, and they now regard cyber breaches as a cost of doing business. Item 105 of Regulation S-K requires a description of material risks that impact a business, and a majority of companies choose to disclose cybersecurity risks in the risk factors section of their periodic reports. A 2020 survey of cybersecurity disclosures for 76 of the Fortune 100 companies from 2018 to May 2020 found that all of the companies disclosed cybersecurity as a risk factor and only one company in 2020 did not disclose data privacy as a risk factor. Cybersecurity also has become


a core component of ESG and sustainability-related frameworks.\textsuperscript{726}

Cyber breaches have spawned substantial EDSL.\textsuperscript{727} From 2018–2019 approximately 50 securities lawsuits—many of which were class actions—were filed following data security incidents,\textsuperscript{728} with plaintiffs alleging inadequate pre-breach disclosure of cyber risks, overstatement of cyber strengths, or delayed disclosure to the market following breach detection.\textsuperscript{729} Additional actions were commenced in 2020 and six cyber-related securities class actions were filed from January–July 2021.\textsuperscript{730}

One example is the securities class action filed in January 2021 after the world’s most audacious and sophisticated cyberattack took place. This attack was launched with the likely backing of the Russian government against defendant SolarWinds, a network infrastructure management company whose 300,000 global clients include most of the Fortune 500 as well as all five branches of the U.S. military.\textsuperscript{731} The networks of approximately 18,000 SolarWinds clients (including at least nine U.S. federal agencies) were compromised, and in mid-2021—while the EDSL was pending—the SEC was investigating whether corporate victims failed to disclose the effects of the espionage on their businesses.\textsuperscript{732} The motion to


\textsuperscript{727} See Peter Halprin, Pamela Woods & Nicole Pappas, Cybersecurity Event-Driven Securities Litigation Has Arrived, LAW360 (Jan. 12, 2021, 5:59 PM), https://www.law360.com/articles/1343650 [https://perma.cc/DPJ4-2QHA] (observing that EDSL “appears to have arrived in the cybersecurity liability context”).


\textsuperscript{729} See, e.g., In re Equifax Inc. Sec. Litig., 357 F. Supp. 3d 1189, 1205 (N.D. Ga. 2019) (“Specifically, the Plaintiff alleges that the Defendants made multiple false or misleading statements and omissions about the sensitive personal information in Equifax’s custody, the vulnerability of its internal systems to cyberattack, and its compliance with data protection laws and cybersecurity best practices.”).


\textsuperscript{732} U.S. SEC. & EXCH. COMM’N, In the Matter of Certain Cybersecurity-Related Events (HO-14225) FAQs (June 25, 2021), https://www.sec.gov/enforce/certain-cybersecurity-
dismiss by SolarWinds, filed in August 2021, condemned the consolidated complaint—which relied on information provided by ten CWs—as part of the growing trend of event-driven securities litigation, “where any calamity that befalls a public company is framed as a violation of the securities laws. . .”\textsuperscript{733} Derivative litigation against SolarWinds also ensued, based on an alleged breach of the duty of oversight.\textsuperscript{734}

Another recent example of cyber EDSL is the May 2021 litigation that followed a cybersecurity breach at Ubiquiti, which develops and markets equipment and technology platforms for high-capacity Internet access.\textsuperscript{735} One report concluded that “[s]ecurities class actions are now routinely filed by shareholders after the announcement of a data breach.”\textsuperscript{736}

Most of the cybersecurity EDSL has been based on section 10(b) and Rule 10b-5.\textsuperscript{737} Plaintiffs in these cases generally raise—but sometimes conflate—two distinct securities fraud claims that correspond to two distinct investor classes. One class includes shareholders who purchased stock after the company made affirmative statements about the company’s cybersecurity regime and commitment to data privacy but before the breach occurred. The second class includes investors who bought after the breach but prior to the public disclosure,\textsuperscript{738} which has often been delayed.

related-events-faqs [https://perma.cc/L9QG-P2EW] (offering amnesty to companies which addressed outstanding disclosure violations in response to SolarWinds attack prior to responding to SEC’s request for information).
The SEC issued non-binding guidance in 2011739 and 2018740 concerning cybersecurity risks, cyber incidents, and the disclosure of data breaches. A 2014 study concluded that the 2011 guidance had “resulted in a series of disclosures that rarely provide differentiated or actionable information for investors.”741 The 2018 guidance was an updated re-package. The SEC’s two documents collectively emphasized the need to promptly disclose any cybersecurity incidents that are material to investors. However, they were mostly non-specific,742 failed to clarify a company’s duty to update disclosures following the occurrence of a significant cyber event, failed to “create a specific obligation to disclose all cybersecurity incidents in a current report filing,”743 and by late-2021 had not been codified in SEC rules.744 The SEC also published at least one ancillary advisory concerning the development of cybersecurity risk governance standards.745

In 2017 the SEC’s Division of Enforcement created a dedicated Cyber

but cybersecurity enforcement actions have been rare, consistent with the Commission’s general perspective that such actions contravene the public interest when a company has been victimized by a cyber incident. Indeed, the Division has stated that “[w]e do not second-guess good faith exercises of judgment about cyber-incident disclosure.” Prior to mid-2021, the SEC appears to have commenced only two cyber enforcement actions, and in both of them disclosure of the cybersecurity vulnerability lagged awareness of the vulnerability by approximately two years.

Enforcement accelerated beginning in June 2021, and the SEC has underscored that deficient cybersecurity disclosure controls and procedures can generate an enforcement action even in the absence of a disclosure violation, data breach, or third-party intrusion. In addition, it is clear that


750. William Johnson, Scott Ferber & Matthew Hanson, SEC Returns Spotlight to Cybersecurity Disclosure Enforcement, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 1, 2021), https://corpgov.law.harvard.edu/2021/08/01/sec-returns-spotlight-to-cybersecurity-disclosure-enforcement/ [https://perma.cc/R9V7-HT66]. This tally excludes a few actions commenced under SEC Regulation S-P, which requires regulated financial services firms to safeguard the personal data of their customers. Id.


courts may consider the SEC’s 2018 guidance when evaluating whether an omission relating to cybersecurity is materially misleading under Rule 10b-5.\textsuperscript{[753]}

The cyber breach disclosure lag has been significant in the absence of more specific SEC guidance and strict SEC enforcement. A survey of public companies that disclosed cyber breaches from 2011–2019 found that a mean 108 days elapsed before companies discovered the breach and another 49 days, on average, before the breach was announced.\textsuperscript{[754]} More recently, in 2020 the discovery window was truncated but the disclosure window was longer. In 2020 it took a mean 44 days to discover a breach and a mean 53 days to disclose it after discovery.\textsuperscript{[755]} This dichotomy suggests that firms’ cybersecurity controls have improved but disclosures frequently remain untimely. When disclosure does occur it typically does not occur in an SEC filing. Fewer than 30\% of public companies with a cyber breach from 2011–2020 disclosed the breach in such a filing.\textsuperscript{[756]}

Scienter and loss causation are the two elements of section 10(b) claims that have presented the stiffest obstacles to cybersecurity EDSL plaintiffs. The disclosure of a massive data breach suffered by Equifax in September 2017 prompted securities litigation after the company’s stock price plunged by almost 36\%.\textsuperscript{[757]} A motion to dismiss was mostly denied in 2019,\textsuperscript{[758]} and this decision marked the first time that scienter and loss causation allegations survived a motion to dismiss in a cybersecurity event-driven case.\textsuperscript{[759]}

Loss causation allegations in prior cybersecurity cases often suffered from the defect that disclosures of even large breaches were unaccompanied by a significant stock price decline.\textsuperscript{[760]} A 2016 study by Georgetown University’s Security and Software Engineering Research Center analyzed

\footnotesize{with First American Financial Corporation, a Fortune 500 company that provides title insurance and other financial services).}

\footnotesize{753. \textit{In re} Alphabet, Inc. Sec. Litig., No. 20-15638, 2021 WL 2448223, at *8 (9th Cir. June 16, 2021).}

\footnotesize{754. \textsc{Audit Analytics}, \textit{Trends in Cybersecurity Breach Disclosures} 5 (May 2020), https://www.auditanalytics.com/audit-analytics-reports [https://perma.cc/W5EV-8YN8].}


\footnotesize{756. \textit{Id.}}


\footnotesize{758. \textit{Id.} at 1252.}

\footnotesize{759. Gesser, Blakemore & Bozzo, \textit{supra} note 738.}

the impact of disclosed breaches by 64 publicly traded companies and concluded that “the announcement of data breaches does not have a meaningful impact on the volatility of equities across industries, and does not meaningfully depress the stock longer than a week.”

More recently, the market has reacted to data breaches. As noted, Equifax’s share price plunged more than 35% following disclosure of the company’s breach, and other major adverse price movements following breach disclosures have occurred at Yahoo and elsewhere. For example, a 2021 survey of 34 large companies that experienced one or more data breaches found that three years after the breach their average share prices underperformed the Nasdaq by -15.6%. These negative price movements have helped shape some sizable settlements. The Equifax EDSL settled for $149 million in 2020, and this resolution was accompanied by a $32.5 million settlement in a parallel derivative suit. The company also agreed to pay a combined $700 million to resolve federal and state claims and hundreds of civil consumer fraud class actions. Earlier, in 2018 the Yahoo EDSL settled for $80 million, the related Yahoo derivative suits settled for $29 million, and Yahoo settled with the SEC for $35 million in the agency’s first enforcement action based on a cybersecurity disclosure violation. The SEC’s dedicated Cyber Unit was responsible for the investigation that led to charges against Yahoo.

The foregoing settlements may encourage plaintiffs’ class action

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764. Id.


counsel to pursue future cybersecurity event-driven litigation. However, *Equifax* may be an outlier, insofar as the data breach was vast (it exposed the personal information of 150 million U.S. consumers), the breach revealed particularly sensitive data, and the impact on the company and its share price was immense.⁷⁶⁸ Equifax’s stock made a partial recovery, but three months after the breach was disclosed the company’s market capitalization still was down approximately $3 billion.⁷⁶⁹ In addition, by the time the operative class action complaint was filed in *Equifax*, plaintiffs had compiled a treasure trove of relevant evidence, including congressional testimony by former senior Equifax executives and numerous investigative media reports.⁷⁷⁰ This combination of critical factors will rarely occur in other cases.

To gauge the prospects of future cybersecurity EDSL it is useful to examine the decisions on motions to dismiss in *Equifax* and other data breach cases. The *Equifax* opinion is particularly instructive. To begin, the Georgia federal district court rejected defendants’ argument—which, as noted *supra*, is often lodged against EDSL in general—that plaintiffs merely alleged non-actionable corporate mismanagement. As the court properly held, allegations that defendants made misleading statements or omissions concerning corporate mismanagement at Equifax could support a section 10(b) claim.⁷⁷¹ The court also distinguished *Heartland Payment Systems*, a prior case that over the years had become a poster child for failed data breach securities litigation. *Heartland* was dismissed in large part because plaintiffs attempted to show falsity merely by alleging that defendant had suffered a security breach after stating that it placed a high emphasis on maintaining a high level of security.⁷⁷² In contrast, in *Equifax*, plaintiffs alleged falsity by characterizing defendants’ data security system as dangerously deficient and falling far short of industry standards.⁷⁷³ The *Equifax* opinion also rejected defendants’ puffery defense because their statements about security were not

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⁷⁷¹ 357 F. Supp. 3d at 1217–18.


⁷⁷³ 357 F. Supp. 3d at 1221.
obviously unimportant to a reasonable investor.\textsuperscript{774} Finally, the court concluded that plaintiffs adequately alleged loss causation, although it declined to accept the materialization of risk theory in the absence of endorsement by the Eleventh Circuit.\textsuperscript{775}

Other decisions have been mostly negative for plaintiffs. In data breach EDSL against Federal Express involving a Russian cyberattack on the company’s European shipping subsidiary TNT, the court dismissed the complaint in 2021 after defendants accused plaintiffs of attempting to “exploit this recent trend towards ‘event-driven’ litigation.”\textsuperscript{776} The court dismissed partly because information provided by a CW was insufficiently specific to establish the falsity of defendants’ statements, which also were protected by at least two of the three prongs of the PSLRA’s safe harbor.\textsuperscript{777}

Similarly, in 2021 the court dismissed data breach EDSL against software company Zendesk, because plaintiffs failed to adequately plead both scienter and a material misstatement or omission. The court granted leave to file a third amended complaint,\textsuperscript{778} but plaintiffs opted to appeal and the Ninth Circuit affirmed the dismissal in 2022.\textsuperscript{779} Earlier, in 2020, the Ninth Circuit affirmed the dismissal of cybersecurity EDSL against PayPal, based on plaintiffs’ failure to adequately allege scienter,\textsuperscript{780} after the district court had concluded that statements by plaintiffs’ CWs were insufficiently indicative of scienter.\textsuperscript{781}

Cybersecurity EDSL against Facebook also was dismissed in 2020, with leave to amend. Prior to the dismissal Facebook agreed in 2019 to pay a $5 billion penalty imposed by the Federal Trade Commission (FTC) in connection with the company’s violation of a 2012 consent decree concerning data privacy practices.\textsuperscript{782} The civil penalty was one of the largest ever assessed by the federal government for any violation and dwarfed all prior fines by the FTC in a privacy case. Simultaneously, Facebook settled

\textsuperscript{774} Id. at 1224.
\textsuperscript{775} Id. at 1250.
\textsuperscript{780} Eckert v. PayPal Holdings, Inc., 831 F. App’x 366 (9th Cir. 2020).
with the SEC for $100 million in connection with the Cambridge Analytica scandal,\(^\text{783}\) in which the personal data of millions of Facebook users was collected without their consent by the British consulting firm. Facebook also agreed in 2020 to pay $550 million in the largest-ever cash settlement resolving privacy-related private litigation, in connection with the company’s use of biometric software.\(^\text{784}\) So Facebook was no stranger to data privacy issues. However, in the cybersecurity EDSL, which also involved the Cambridge Analytica scandal, Facebook prevailed. The court held that various statements by defendants were protected by the PSLRA’s safe harbor, other statements were not false, and plaintiffs had failed to adequately plead loss causation.\(^\text{785}\)

In contrast, in 2021 the Ninth Circuit largely reversed the district court’s dismissal of consolidated cybersecurity EDSL against Google, parent company Alphabet, and some of their top executives. Security vulnerabilities in the Google+ social network had exposed user data from more than 50 million accounts—although apparently no actual breach occurred—and securities litigation ensued, with Rhode Island designated as lead plaintiff. The district court dismissed Rhode Island’s amended complaint with leave to further amend, after holding that defendants’ statements about the importance of privacy to users and Alphabet’s general commitment to the protection of its users’ data were non-actionable puffery and plaintiffs had failed to adequately allege scienter.\(^\text{786}\) Plaintiffs declined to amend and instead appealed after the district court entered judgment.\(^\text{787}\)

This strategy succeeded. The Ninth Circuit cited *Matrixx* and the SEC’s 2018 cybersecurity disclosure guidance and concluded that statements made by Alphabet in two of its 2018 10-Qs were materially misleading insofar as they omitted to mention the Google+ security vulnerabilities of which Google then was aware.\(^\text{788}\) According to the court, the 10-Q omissions “significantly altered the total mix of information available for decisionmaking [sic] by a reasonable investor.”\(^\text{789}\) The Ninth Circuit also

\(^{783}\) *Id.*.


\(^{785}\) *In re Facebook, Inc. Sec. Litig.*, 477 F. Supp. 3d 980, 1028 (N.D. Cal. 2020).


\(^{787}\) *In re Alphabet, Inc., Sec. Litig.*, 1 F.4th 687 (9th Cir. 2021).

\(^{788}\) *Id.* at 703.

\(^{789}\) *Id.* at 704–05.
concluded that plaintiffs had adequately alleged scienter, notwithstanding the absence of allegations from CWs.\footnote{790} Plaintiffs also prevailed in the earlier consolidated cybersecurity EDSL against Yahoo, which involved two separate significant data breaches in 2013 and 2014. Plaintiffs alleged that Yahoo misled investors by failing to disclose the breaches in its public filings while touting the strength of its cybersecurity practices, and indeed the breaches were not disclosed until 2016.\footnote{791} The litigation settled for $80 million in 2018 after the court denied as moot motions to dismiss, leave to amend was granted, and an amended complaint was filed.\footnote{792} This was the first major recovery in a section 10(b) action based on a company’s alleged failure to adequately disclose cybersecurity incidents and risks.

Yahoo, like Equifax, might constitute an outlier. The Yahoo double breaches, disclosed almost two years after the fact, were massive and had a material impact on the company. The breaches compromised all of Yahoo’s three billion user accounts and were not disclosed to the investing public until Yahoo was in the process of closing the acquisition of its core operating Internet business by Verizon Communications.\footnote{793} Post-disclosure, the business was acquired by Verizon for $350 million less than the $4.83 billion it previously had offered.\footnote{794} This specific fact pattern also is unlikely to replicate in future cases.

Still, Equifax, Yahoo, and Google no doubt serve to encourage plaintiffs’ class action counsel to pursue additional cybersecurity EDSL. In late-2021 such litigation was pending against multiple other companies, including Zoom and Capital One.\footnote{795} Plaintiffs in these cases and future

\footnote{790. Id. at 707. The Ninth Circuit subsequently denied the request by Alphabet and Google for an \textit{en banc} rehearing. Order, \textit{In re} Alphabet, Inc., Sec. Litig., No. 20-15638 (9th Cir. July 23, 2021).


793. See \textit{Yahoo Settlement}, \textit{supra} note 767.


795. \textit{Sec., e.g., In re} Zoom Sec. Litig., No. 20-cv-02353 (N.D. Cal. Apr. 7, 2020) (EDSL arising from Zoom’s alleged false and misleading statements concerning its data privacy and security risks). In February 2022 the federal district court granted in part and denied in part defendants’ motion to dismiss in the Zoom EDSL, with leave to amend. \textit{In re} Zoom Sec. Litig., No. 20-cv-02353-JD, 2022 WL 484974 (N.D. Cal. Feb. 16, 2022).}
actions likely will encounter many of the same issues that were dispositive in the unsuccessful litigation discussed above. Indeed, in September 2021 a federal district court in California dismissed cyber EDSL against First American Financial Corporation, a Fortune 500 company, after concluding that various of defendants’ subject statements were non-actionable puffery.\textsuperscript{796}

Likewise, in June 2021 the federal district court in Maryland dismissed with prejudice both consolidated securities class actions and consolidated derivative actions against Marriott stemming from a massive data breach in the hotel giant’s Starwood guest reservation system. Hackers stole the personal information of up to 500 million guests and a raft of litigation ensued. In the securities class actions the court applied both the safe harbor and the bespeaks caution doctrine, distinguished \textit{Equifax} and concluded that Marriott’s statements concerning a commitment to safeguard customer privacy were non-actionable puffery, and, \textit{inter alia}, discounted information concerning scienter provided by seven CWs.\textsuperscript{797} In the federal derivative actions the federal securities claims were dismissed primarily because plaintiff failed to own Marriott shares during the relevant time period.\textsuperscript{798} A separate derivative action arising from the same cyberattack was dismissed by the Delaware Chancery Court in October 2021.\textsuperscript{799} The \textit{Marriott} and \textit{First American} litigation more generally reflect the fate of cybersecurity EDSL to date than do \textit{Equifax}, Yahoo, and Google.\textsuperscript{800}

\section*{IV. PROPOSED SOLUTIONS TO THE PERCEIVED PLAGUE OF EDSL}

Multiple solutions to the perceived problem of EDSL have been proposed. This part briefly critiques some of the major proposals. At the outset, however, it should be emphasized that, as demonstrated above, there

\textsuperscript{796} Order Granting Defendants’ Motion to Dismiss 16–17, \textit{In re} First American Fin. Corp. Sec. Litig., No. CV 20-9781 DSF (C.D. Cal. Sept. 22, 2021). However, leave to amend was granted. \textit{Id.} at 21.


\textsuperscript{798} \textit{In re:} Marriott Int’l, Inc. Customer Data Security Breach Litig. (Derivative Actions) at 19, MDL No. 19-md-2879 (D. Md. June 11, 2021)


is no substantial problem in search of a solution. A careful examination suggests that much event-driven litigation has merit and courts are well-equipped to dismiss the chaff.

Five reform proposals are addressed herein. First, as noted supra, in 2020 the U.S. Chamber of Commerce filed a rulemaking petition with the SEC seeking to restrict pandemic EDSL. The Chamber asked the SEC, inter alia, to bar liability for statements about the impact of COVID-19 on a company’s business, whether forward-looking or not, so long as suitable warnings were attached. For the reasons discussed, the Chamber’s petition was misguided. It rested upon a broad, shallow critique of event-driven litigation that was tied in part to a rejection of plaintiffs’ use of the widely accepted materialization of risk theory to show loss causation. The petition also falsely assumed that courts would be inundated by a wave of unjustified pandemic cases, and it weakly argued that the PSLRA’s safe harbor requires revision.

A second proposal is for Congress to permit interlocutory appeals of denials of motions to dismiss, either as of right or based upon a discretionary standard. Multiple state courts, including New York, allow such appeals. In contrast, under the Federal Rules of Civil Procedure, the denial of a motion to dismiss does not qualify as a final decision (and thus there is no appeal as of right), and discretionary appeals generally land outside the scope of 28 U.S. § 1292(b). That statute requires district court certification that the order involves a controlling question of law as to which there is substantial ground for a difference of opinion, and for which an immediate appeal may materially advance the ultimate termination of the litigation. The appellate court then must exercise its discretion to allow the appeal.\footnote{Katayoun Donnelly & Blain Myhre, \textit{Pushing Pause: Interlocutory Appeals under 28 U.S.C. § 1292(b)}, American Bar Ass’n (June 3, 2019), https://www.americanbar.org/groups/litigation/committees/appellate-practice/articles/2019/spring2019-pushing-pause-interlocutory-appeals-under-28-usc-1292b/ [https://perma.cc/97H6-8TWD].}

Unsurprisingly, section 1292(b) has been applied “relatively sparingly and in exceptional cases.”\footnote{In re Equifax Inc. Sec. Litig., No. 17-CV-3463-TWT, 2019 WL 3449673 (N.D. Ga. July 29, 2019).} For example, in the Equifax EDSL the court denied Equifax’s request to file an interlocutory appeal of the order on the motion to dismiss.\footnote{Pincus, supra note 70, at 5.} The proposal to revise the Federal Rules stems from the critical role that motions to dismiss play in securities litigation. If motions are denied, “class certification and settlement virtually always follow.”\footnote{28 U.S.C. § 1292(b).} The Equifax settlement that followed denial of the motion to
dismiss and denial of interlocutory appeal was the largest to date in cybersecurity EDSL. Similarly, FCPA-related EDSL against Cognizant Technology Solutions Corporation settled for $95 million in September 2021. However, a fundamental problem with this reform proposal is that expanding appeals as of right or on a discretionary basis likely would flood the Circuits with meritless appeals. One of the primary objectives of section 1292(b) is to preserve the institutional efficiency of the federal court system. A torrent of appeals, many of them meritless, would undermine that objective.

A third proposal is for Congress to amend the PSLRA and simultaneously strengthen the statute’s pleading standard and discovery stay. Such a proposal is unsupported by any compelling evidence that the onerous pleading standard fails to separate the wheat from the chaff, or that the strict discovery stay has failed to accomplish its intended purpose. Indeed, the universal use by plaintiffs of confidential witnesses essentially proves that the stay is operating as designed. In the absence of a powerful stay provision reliance on CWs would be unnecessary.

A fourth proposal is for Congress to enact a cap on damages in non-IPO cases because securities class actions simply shift money from current shareholders to plaintiff shareholders. This proposal also seems misguided. As noted, the PSLRA already includes a bounce-back provision which caps damages at the difference between plaintiff’s purchase price and the mean trading price of the security during the 90 days following a corrective disclosure. The provision functions as a rescissory cap on out-of-pocket damages in securities fraud litigation and it can eradicate recovery. The larger debate about the benefits of securities class action litigation is

807. Donnelly & Myhre, supra note 802.
808. Pincus, supra note 70, at 5. The PSLRA imposes an automatic stay of all discovery and other proceedings during the pendency of a motion to dismiss, absent application of one of two exceptions—when particularized discovery is necessary to preserve evidence or to prevent undue prejudice to the party seeking relief. 15 U.S.C. § 78u-4(b)(3)(B).
809. See, e.g., In re BofI Holding, Inc. Sec. Litig., Case No. 15-CV-02324-GPC-KSC, 2016 WL 5390533, at *16 (S.D. Cal. Sept. 27, 2016) (“The Court is aware that confidential witnesses have become a staple of securities litigation.”).
810. Pincus, supra note 70, at 5.
beyond the scope of this Article. Here, it suffices to note that an effective damages cap already exists, and since fewer than 1% of securities cases proceed to trial the imposition of a further cap seems superfluous, with potential major drawbacks that include a chilling effect on the filing of meritorious cases.

A fifth proposal is to adopt a rule requiring plaintiffs in securities litigation who lose motions to dismiss to pay the prevailing defendants’ attorneys’ fees, under the theory that fee-shifting would re-align the cost-benefit analysis for investors considering pursuing tenuous claims. Such a requirement would contravene the solid policy rationales justifying the long-standing American Rule, pursuant to which prevailing parties are not entitled to recover their attorneys’ fees. A major drawback to the fifth proposal is the inherent inequity of making fee-shifting one-directional. A second drawback is, again, the substantial chilling effect the new rule would have on meritorious securities class action litigation. In 2015 Delaware’s state legislature amended the Delaware General Corporation Law to prohibit Delaware stock corporations from including in their charters or bylaws loser-pays provisions in connection with “internal corporate claims” brought by stockholders. This prohibition, encompassing those claims typically brought in M&A and corporate governance litigation, was adopted in large part to address the chilling impact that loser-pays provisions could have on the enforcement by stockholders of fiduciary duties. The Delaware amendment is instructive in the EDSL context, even if it does not clearly cover federal securities claims.

CONCLUSION

Securities class action litigation has experienced a major transformation in recent years. Whereas securities cases previously focused on financial or accounting fraud, increasingly such actions are based on the alleged concealment or misrepresentation of substantial adverse events. The new focus is the defining characteristic of event-driven securities litigation. EDSL has raised numerous difficult issues that have recurred across some of
the major categories of the litigation, including COVID-19, cannabis, foreign and domestic corruption, antitrust, #MeToo, and cybersecurity. Careful examination of EDSL suggests that much of it has merit. Recent proposals to restrict the litigation either legislatively or judicially are mostly unjustified. Courts already are well-equipped to weed out the meritless cases, and many of the restrictive proposals seem designed merely to sharply tilt the litigation playing field in favor of corporate defendants.