haynesboone

Securities Litigation

2020 Year in Review

Clients and Friends,

2020 was a challenging year in so many ways. While the world of securities litigation and SEC enforcement continued to turn, it is no surprise that the global pandemic had an impact on new case activity. Federal securities class action filings declined from recent year record levels (but still exceeded historical levels), and new SEC enforcement actions declined significantly on a fiscal year-over-year basis.

Our **2020 Year in Review** focuses on significant securities-related decisions by the Supreme Court and federal appellate courts, key developments in SEC enforcement, and significant selected trends in state law fiduciary litigation against directors and officers of public companies.

We begin with a discussion of the Delaware Supreme Court's approval of forum selection clauses intended to allow companies to address the phenomenon of public offering federal securities claims in state court. There was notable activity at the Circuit Courts of Appeals on key issues of scienter, falsity, loss causation and class certification. We also highlight trends in shareholder litigation against Boards of Directors and updates on SEC enforcement, including recent statutory changes addressing the U.S. Supreme Court's recent disgorgement decisions.

The Haynes and Boone team spent 2020 working from home without missing a beat. Among other highlights, we won affirmance of the dismissal of a shareholder derivative suit against the Board of Tenet Healthcare; helped obtain dismissal of securities class actions against AT&T; defended underwriters, companies and executives in securities cases across the country; and helped companies and executives in SEC enforcement and internal investigations.

If you have any questions about the issues covered in this 2020 Review, or about our practice, please let us know. We look forward to working with our friends and clients in 2021.

Daniel Gold

DAN GOLD
Chair, Securities and Shareholder Litigation Practice Group

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Meet the Authors

DAN GOLD is Chair of the firm's Securities and Shareholder Litigation practice group and has been recognized by *Chambers USA*, *Best Lawyers* in Dallas, and *Acritas Stars*. Among other recent matters, Dan won affirmance of the dismissal of shareholder derivative litigation against the Board of Tenet Healthcare, helped obtain dismissal of securities class actions against AT&T, and is defending Exxon, Liberty Oilfield Services, Huntsman Corporation and other companies in securities and shareholder litigation. He also regularly advises companies and investment funds on fiduciary duty and indemnification issues.

KIT ADDLEMAN chairs the firm's national Securities Enforcement Defense group and is a member of the Investment Funds Practice group. Kit defends companies, executives and directors against government charges of misconduct, particularly investigations and litigation by the SEC and DOJ. Many of her matters involve allegations of accounting and financial fraud, insider trading, hedge fund and advisor fraud, and Foreign Corrupt Practices Act violations. Prior to joining Haynes and Boone, Kit was the regional director of the SEC's Atlanta Regional Office and spent more than 20 years prosecuting matters in four SEC offices around the country.

THAD BEHRENS is Chair of the firm's Class Action Defense practice. He has a vibrant securities litigation practice, having been recognized by *Chambers USA* for his excellence in defending companies, directors, officers and underwriters in securities class actions and derivative suits. His recent experience includes obtaining a dismissal of a securities class action for Tenet Healthcare, defending Goldman Sachs & Co. and the underwriting syndicate in a securities class action, and defending Liberty Oilfield Services and Huntsman Corporation in state and federal securities class actions. Thad is a past president of the Dallas Federal Bar Association and has been recognized as a Texas Super Lawyer and a Best Lawyer in Dallas.

EMILY WESTRIDGE BLACK focuses her practice on defending clients in high-stakes cases, including securities litigation, class actions, and complex commercial disputes. She also has extensive experience conducting internal investigations arising from allegations of corruption, fraud, and securities law violations. She honed her common-sense, business-oriented approach to legal work during her time working in-house for one of the world's largest pharmaceutical companies. Emily's creative and tenacious approach to client advocacy was recently recognized by *Texas Lawyer*, which selected her as the 2019 Attorney of the Year.

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TIM NEWMAN represents clients in government enforcement actions and complex litigation. He has extensive experience representing organizations and executives under investigation by the SEC, DOJ, FINRA, and state regulators and conducting internal investigations related to suspected accounting fraud, offering fraud, insider trading, and other securities law violations. Tim has been recognized as a "Rising Star" by the *Texas Super Lawyers* directory and was recently featured in *D Magazine*'s "Best Lawyers Under 40" List.

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Special thanks to the following attorneys and staff for their contributions and assistance:

Tammie Banko, Joseph Browning, Carrington Giammittorio, Benjamin Goodman, Kathy Gutierrez, Katie Kelley, Casey McGovern, William Marsh, and Noor Wadi.

I. Federal Forum Selection Clauses: the Answer to *Cyan*?

In *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020), the Delaware Supreme Court issued an important opinion that has significant implications for securities class action litigation related to public offerings. The court held that a provision in a corporate charter requiring that claims for violations of the federal Securities Act of 1933 ("Securities Act") be brought exclusively in federal court is valid under Delaware law. This decision provides an avenue for corporations to address the consequences of the U.S. Supreme Court's ruling in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), that state courts have concurrent jurisdiction with federal courts over Securities Act claims and that actions asserting only Securities Act claims filed in state court could not be removed.

In reaction to *Cyan*, several corporations, prior to their initial public offerings, adopted "federal forum provisions" in their certificates of incorporation that required shareholders to bring Securities Act claims exclusively in federal court. However, there were questions as to whether these provisions were valid and enforceable under Delaware law.

In *Salzberg*, a plaintiff challenged the facial validity of federal forum provisions adopted by three separate corporations. The trial court held that federal forum provisions were invalid under Delaware law, reasoning that the "constitutive documents of a Delaware corporation cannot bind a plaintiff to a particular forum when the claim does not involve rights or relationships that were established by or under Delaware's corporate law." The Delaware Supreme Court reversed and held that: "[federal forum provisions] involve a type of securities claim related to the management of litigation arising out of the Board's disclosures to current and prospective stockholders in connection with an IPO or secondary offering. The drafting, reviewing, and filing of registration statements by a corporation and its directors is an important aspect of a corporation's management of its business and affairs and of its relationship with its stockholders. . . . [A] bylaw that seeks to regulate the forum in which such 'intra-corporate' litigation can occur is a provision that addresses the 'management of the business' and the 'conduct of the affairs of the corporation,' and is, thus, facially valid under [Delaware law]."

Additionally, the court found that federal forum provisions advance Delaware policy goals because they eliminate the prospect of wasteful multi-forum litigation. According to a study performed by Stanford Law School and cited by the Delaware Supreme Court, 45 percent of Securities Act cases filed in state court in 2019 had a parallel action filed in federal court asserting the same claims. Federal forum provisions thus can facilitate consolidation of Securities Act cases in a single federal forum.

The Delaware Supreme Court further took the position that federal forum provisions in the charters of Delaware corporations should be enforced in other states' courts for several reasons. First, the Court noted that corporate charters are considered contracts among the corporation's shareholders, and contractual forum selection provisions are generally viewed as "presumptively valid," unenforceable only in narrow circumstances where enforcement would be "unreasonable and unjust," involve "fraud or overreaching," or "contravene a strong public policy of the forum in which suit is brought." Second, enforcement of federal forum provisions found in corporate charters comport with the internal affairs doctrine, a conflict of law principle that provides the law of the state of incorporation should govern questions regarding a corporation's internal affairs. Third, federal forum provisions are "process-oriented" and do not alter substantive rights created by other states' laws. And fourth, federal forum provisions are less restrictive than Delaware forum provisions for fiduciary duty claims that have been widely enforced by other states because they would not prevent a plaintiff from bringing a claim in the plaintiff's home state, albeit in federal court.

Questions unanswered in *Salzberg* included whether courts would enforce federal forum provisions (i) adopted after a public offering or after litigation commenced, (ii) for non-Delaware corporations, (iii) for Delaware corporations sued in non-Delaware courts, (iv) contained in corporate bylaws rather than charters, or (v) for Securities Act claims against defendants other than the stock issuer.

Following *Salzberg*, other courts began to answer some of these open issues as many public companies adopted federal forum provisions in their charters or bylaws. Three California state courts enforced federal forum provisions for Delaware companies in *Wong v. Restoration Robotics, Inc.*, No. 18CIV02609 (Cal. Super. Ct. San Mateo Sept. 1, 2020), *In re Uber Tech. Sec. Litig.*, No. CGC-19-579544 (Cal. Super. Ct. San Francisco Nov. 16, 2020), and *In re Dropbox, Inc. Sec. Litig.*, No. 19-CIV-05089 (Cal. Super. Ct. San Mateo Dec. 4, 2020). In all three cases, the courts held the federal forum provisions were enforceable under California law.

One key difference was that the courts in *Uber* and *Dropbox* held the federal forum provision applied to Securities Act claims against all defendants, including underwriters, whereas the court in *Restoration Robotics* held that Securities Act claims against underwriters could not be dismissed based on an issuer's federal forum provision. This issue will certainly continue to be litigated in other cases.

The *Dropbox* opinion also notably involved a federal forum provision in the company's bylaws, rather than the charter. The court reasoned that the same standards apply to enforceability of provisions in either document. It is generally easier to adopt a new bylaw than to amend a charter, so *Dropbox* is a positive sign for companies that may be looking for the most efficient path for adopting an enforceable federal forum provision.

The implications of *Salzberg* and the trend towards following it are significant. *Salzberg* essentially allows a Delaware corporation to force plaintiffs to litigate Securities Act claims in federal court. This helps avoid multi-forum litigation and inherent uncertainties associated with litigating Securities Act claims in state courts, where rules and procedures are often less clear and less robust than their federal counterparts. Further, litigating Securities Act claims in federal court ensures that all of the provisions of the Private Securities Litigation Reform Act are enforced. Insurance carriers also may view federal forum provisions as reducing litigation risks associated with public offerings and adjust premiums accordingly.

II. Courts Continue to Dismiss Claims for Failure to Plead Falsity or Materiality

Federal circuit courts in 2020 issued several significant opinions on the dismissal of claims at the motion to dismiss stage for failure to plead falsity or materiality. Courts relied on several grounds in finding a failure to adequately plead a material false or misleading statement.

OPINION STATEMENTS UNDER OMNICARE

Courts continue to apply the Supreme Court's *Omnicare* decision when analyzing whether opinion statements are actionable, occasionally seeming to disagree on whether *Omnicare* expanded or restricted liability for expressions of belief. *See Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund*, 575 U.S. 175 (2015). The Second Circuit, for example, recently stated that Omnicare "increase[ed] the ability" to plead an actionable opinion, while the Third Circuit stated that *Omnicare* imposes a "rigorous benchmark." *Abramson v. Newlink Genetics Corp.*, 965 F.3d 165, 174-76 (2d Cir. 2020); Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 717 (3d Cir. 2020).

In *Jaroslawicz v. M&T Bank Corp.*, the plaintiff did not adequately plead an actionable opinion, even where the opinion regarding the company's compliance program and timing of regulatory approval for a merger turned out to be wrong. 962 F.3d at 717-18. There, the company accurately disclosed the due diligence it performed to reach this opinion, and even though the plaintiff would have expected more diligence, "divulg[ing] an opinion's basis" is all that is needed "to avoid exposure." *Id.*; *see Yan v. ReWalk Robotics Ltd.*, 973 F.3d 22, 32-33 (1st Cir. 2020) (affirming grant of motion to dismiss because the basis for the opinion statement was disclosed and there were no contrary, non-disclosed facts); *Shreiber v. Synacor, Inc.*, --- F. App'x ----, 2020 WL 6165909, at *1-2 (2d Cir. Oct. 22, 2020) (affirming grant of motion to dismiss where the complaint targeted opinions about future revenue from a contract but did not plausibly allege the company (i) disbelieved the opinion, (ii) supplied an untrue fact in support thereof, or (iii) omitted material information).

In *Abramson v. Newlink Genetics Corp.*, on the other hand, the Court held that the plaintiff plausibly pled an actionable opinion regarding clinical trials where the opinion—all major studies show survival rates of at most 20 months—implied the *fact* that no credible studies found survival rates higher than 20 months and where the speaker allegedly knew studies had. 965 F.3d at 176-78.

THE ACTUAL STATEMENTS AT ISSUE, NOT PLAINTIFFS' INTERPRETATIONS OF THEM, MATTER

Appellate courts refused to accept plaintiffs' interpretations of challenged statements as true and, instead, analyzed what the statements actually said to determine that defendants did not make false statements. *See In re Liberty Tax, Inc. Sec. Litig.*, 828 F. App'x 747, 752-53 (2d Cir.

2020) (rejecting plaintiff's claims of falsity after "comparing the allegations . . . to the substance" of the actual statements); *see also Colbert v. Rio Tinto PLC*, 824 F. App'x 5, 10-11 (2d Cir. 2020) (same when reading company's disclosures "in context" and not what plaintiff claimed they "purport to state"); *Yan*, 973 F.3d at 31-32 (similar).

IMMATERIAL PUFFERY

Appellate courts affirmed dismissals at the pleading stage where challenged statements were nothing more than immaterial puffery on which no reasonable investor would rely. *See*, *e.g., Liberty Tax*, 828 F. App'x at 750-51 (affirming dismissal because company's statement that it successfully evaluated its compliance program did not describe "when" or "how" the work was done and provided "no qualitative assurances and affirmative guarantees"). Defendants successfully invoked this defense to protect statements touting the results of medical clinical trials. *See Abramson*, 965 F.3d at 173-74 (affirming dismissal where company described drug trials as "encouraging" and "an improvement"); *Yan*, 973 F.3d at 32-33 (same regarding "compelling clinical data" for a "breakthrough product").

PROTECTED FORWARD-LOOKING STATEMENTS

Defendants also obtained dismissals that appellate courts affirmed where plaintiffs challenged forward-looking statements that were accompanied by meaningful risk factors. *See Yan*, 973 F.3d at 34-35 (company explained its "expectations" for clinical research but also risks that can cause results to differ); *Heinze v. Tesco Corp.*, 971 F.3d 475, 483-84 (5th Cir. 2020) (company's financial "projections" and "forecasts" were followed by risks that can affect the accuracy of them). But boilerplate risk factors do not protect these statements. *See Jaroslawicz*, 962 F.3d at 714-15 (holding "generic" risk factors about regulatory review of merger that "omitted company-specific detail" did not satisfy the safe harbor), *petition for cert. filed*, No. 20-678 (Nov. 15, 2020).

CORPORATE MISMANAGEMENT IS NOT FRAUD

While plaintiffs often sue immediately after poor financial results or once a business strategy proves unsuccessful, courts reiterated that a bad business decision is not enough to adequately plead fraud. *See Colbert*, 824 F. App'x at 10 (affirming grant of motion to dismiss and stating that an "unwise" investment "is not, standing alone, enough to render the statement" misleading); *In re Newell Brands, Inc. Sec. Litig.*, --- F. App'x ----, 2020 WL 7040968, at *6 (3d Cir. Dec. 1, 2020) (same and stating "[b]ad business decisions, without more, do not constitute federal securities fraud").

III. Appellate Decisions on Pleading Scienter

Plaintiffs must clear a challenging hurdle in asserting a securities fraud claim—pleading a strong inference of scienter. To establish a claim under Section 10(b) and Rule 10b-5, a plaintiff must allege that the defendant acted with scienter, the intent to deceive, manipulate, or defraud, or at least severe recklessness. Scienter must be pled with factual particularity, and the Supreme Court has held that the inference of scienter must be at least as compelling as any opposing inference.

Recent appellate cases highlight some of the interesting scienter issues being addressed by the courts.

THE THEORY OF FRAUDULENT INTENT MUST MAKE SENSE

Court of Appeals decisions addressing scienter in 2020 highlight the degree to which a court will scrutinize whether a plaintiff's theory of fraudulent intent makes sense. In *Nguyen v. Endologix, Inc.*, 962 F.3d 405 (9th Cir. 2020), the plaintiff alleged that Endologix, a medical device manufacturer, made false statements about the supposedly promising prospects of FDA approval for a new product despite the product's failure to meet certain standards in Europe. The court rejected this theory of scienter as having "no basis in logic or common experience" because it was not "plausible" that a company would make optimistic statements about FDA approval with knowledge otherwise based solely on a European study that used different metrics than those required by the FDA. *Id.* at 408. Instead, "the more plausible" inference was that the optimistic statements stemmed from "U.S. testing [that] looked promising," not the company's "quixotic[]" pursuit of "FDA approval for a medical device application it knew was destined for defeat." *Id.* Moreover, plaintiff was "hard-pressed to build a fraud case around the [European] study when she admit[ted] in her complaint" that the CEO "discussed this very study on an investor conference call." *Id.* at 417. Because her theory simply did "not make a whole lot of sense," plaintiff "failed to plead a strong inference of scienter." *Id.* at 415, 419.

Similarly, in *In re Target Corporation Securities Litigation*, 955 F.3d 738 (8th Cir. 2020), the Eighth Circuit held that investor-plaintiffs failed to adequately plead a strong inference of scienter where the defendant's actions undercut the plausibility of plaintiff's theory. Investors sued Target, alleging that Target executives understated the seriousness of its problems with Target Canada and overstated their ability to correct them with unrealistic projections about the profitability of the Canadian stores. *Id.* at 741. Plaintiffs failed to make a "'compelling' case for fraud" where they explicitly pleaded that "Target's efforts to finally implement changes to address systemic problems with its supply chain IT systems came in too little too late." *Id.* at 743. From these allegations, the court concluded that the "more compelling inference" was "that Target executives did not understand the magnitude of the problems they faced." *Id.* This was "fatal" to plaintiff's complaint. *Id.*

As suggested in *Endologix* and *Target*, plaintiffs' scienter allegations may not "make sense" when a company's disclosures provide information undercutting an inference of fraudulent intent. The First Circuit's decision in *Mehta v. Ocular Therapeutix, Inc.*, 955 F.3d 194 (1st Cir. 2020) is a good example. In *Mehta*, Ocular Therapeutix submitted two New Drug Applications ("NDA") to the FDA and allegedly made false and misleading statements regarding the company's use of "good manufacturing practices." The company explained that, as part of the NDA process, the FDA conducted an inspection of the company's manufacturing facility and provided observations which the company either addressed during the inspection or committed to address through a corrective action plan. Ocular Therapeutix explicitly disclosed that any failure to resolve the inspectional observations could result in approval delays. When the NDAs were ultimately rejected for "deficiencies in manufacturing processes," plaintiffs sued. *Id.* at 204. But the court rejected the fraud claim, explaining that defendants had provided "informative disclosures about the nature and consequences" of the FDA's inspection and that these disclosures "undercut any inference that defendants intentionally or recklessly misled investors by stating, in the same Forms 10-K containing those disclosures, that they were 'using current Good Manufacturing Practices' at their manufacturing facility." *Id.* at 208. In sum, these disclosures gave rise to "the more reasonable inference of nonfraudulent intent . . . that defendants were stating their *intention* to comply" with good manufacturing practices, and therefore plaintiffs' allegations could not support a "strong inference" of scienter. *Id.* (emphasis added).

On the other hand, a defendant's own disclosures can, in some cases, bolster a plaintiff's allegations of scienter. *See Setzer v. Omega Healthcare Inv'rs, Inc.*, 968 F.3d 204, 207 (2d Cir. 2020). In *Setzer*, plaintiffs asserted that Omega misled investors by failing to disclose a $15 million working capital loan it made to one of its major tenants that was suffering substantial financial difficulties. Plaintiffs alleged that this omission hid from investors an accurate picture of the tenant's financial position and that Omega was reckless in failing to disclose the working capital loan, which rendered statements about the tenant's performance misleading. The court held that Omega's knowledge of the facts contradicted the public statements made about the tenant. Indeed, the fact that "[d]efendants made several disclosures regarding [the tenant's] financial difficulties [did] not alter [the court's] conclusion" because they "strongly suggest[ed]" that Omega sought to use the tenant's partial rental payments to express unwarranted optimism and "underrepresent the extent of those very problems." *Id.* at 216. Thus, where disclosures are clearly used to conceal unflattering information, such disclosures are likely to support rather than undercut allegations of scienter.

PLEADING CORPORATE SCIENTER

Another scienter issue that received attention at the appellate court level in 2020 was pleading scienter against a corporation. "Ascribing a state of mind to a corporate entity is a difficult and sometimes confusing task," so "most courts look to the discrete roles played by the corporate actors who are connected to the alleged misrepresentation to determine which (if any) fall within the locus of a company's scienter." *Jackson v. Abernathy*, 960 F.3d 94, 98 (2d Cir. 2020). For this reason, when a plaintiff does not identify "any individual whose scienter may be imputed" to the corporation, the plaintiff's scienter allegations as to the corporation typically fail. *Id.* at 99. Further, low-level whistleblower-employees' knowledge of alleged fraud is not sufficient for imputation because the act of "rais[ing] concern" about the fraud "belie[s] any inference of scienter." *Id.* That said, "particularized allegations that senior officers ignored those employees' warnings could demonstrate that those officers acted fraudulently." *Id.*

In a case involving a money-transfer service's alleged false public statements regarding its compliance with anti-money laundering and anti-fraud laws, the Tenth Circuit reiterated that only the scienter of "the *senior controlling officers* of a corporation may be attributed to the corporation itself to establish liability as a primary violator of § 10(b) and Rule 10b-5." *Smallen v. The W. Union Co.*, 950 F.3d 1297, 1312 (10th Cir. 2020). The court rejected plaintiff's contention that the scienter of "*any* Western

Union agent, including lower-level corporate officers who played no role in the misstatement" could be "imputed to the company for purposes of liability under the PSLRA." *Id.* at 1312–13.

These recent cases provide helpful guidance for companies seeking to avoid or undermine allegations of scienter. Courts are open to arguments attacking the plaintiff's theory as lacking common sense, particularly where the defendant executives disclosed negative information that undercuts the suggestion of an intent to mislead. Where company executives lack scienter, the court is likely to find that the company lacks scienter as well.

IV. Loss Causation: Can Publicly Available Information be Considered a Corrective Disclosure?

In a private securities fraud case under the Securities Exchange Act of 1934, a plaintiff must plead and later prove loss causation—the causal connection between the fraudulent misrepresentations underlying a claim and the economic loss suffered by the plaintiff. A plaintiff can satisfy the loss-causation pleading burden by alleging that a "corrective disclosure" revealed the truth of a defendant's misrepresentation and, thereby, caused the company's stock price to drop.

In 2020, the Ninth and Eleventh Circuits both addressed whether information derived from public filings and other publicly available sources can constitute a corrective disclosure when pleading loss causation.

In *Grigsby v. BofI Holding, Inc.*, 979 F.3d 1198, 1206 (9th Cir. 2020) ("BofI"), the Ninth Circuit considered whether "information obtained through a FOIA request can be 'corrective' of an allegedly false and misleading statement by revealing nonpublic information to the market." *Id.* at 1205. Defendants argued that information revealed by a FOIA request was publicly available, and, therefore, could not be considered corrective. The court disagreed, reasoning that "[i]nformation acquired through the FOIA does not simply reside on a shelf somewhere, ready for the taking." *Id.* Further, the court explained that "information must be produced before it is publicly available," and importantly, "not all FOIA requests yield disclosure of the sought-after information." *Id.*

The *BofI* Court also considered whether a *Seeking Alpha* article—written by an anonymous short-seller who had invested in BofI and who stated that he derived his conclusions by comparing information available in public documents—could constitute a corrective disclosure. *Id.* at 1209. The court held it did not, reasoning that the analysis of publicly available information in this article did not require "any expertise or specialized skills beyond what a typical market participant would possess" and did not make any "representation as to the accuracy or completeness of the information." *Id.* Under these facts, the *Seeking Alpha* article did not constitute a corrective disclosure. *Id.*

Similarly, the Eleventh Circuit analyzed partial disclosures to determine whether they collectively constituted a corrective disclosure, despite containing what the district court deemed to be publicly-available information. *Luczak v. Nat'l Beverage Corp.*, 812 F. App'x 915, 921-22 (11th Cir. 2020) ("Luczak"). The *Luczak* plaintiff relied on two documents that he alleged were partial, corrective disclosures: a letter from the SEC to the defendant-company regarding prior public statements and a *Wall Street Journal* article analyzing, *inter alia*, the letters between the SEC and the defendant-company.

The SEC letter requested that the defendant-company reconcile statements made in prior public letters to the SEC with statements made in previously-issued press releases. *Id.* at 922-23. Based on the SEC's request, the plaintiff argued that the letter constituted the first in a series of partial disclosures of corrective information, revealing to the market for the first time that the defendant-company failed to cooperate with the SEC. *Id.* at 922. The district court held that this letter did not constitute a corrective disclosure, because though it "suggest[ed] skepticism with [the defendant-company's] prior response to the SEC," it did not reveal any "previously concealed truth." *Luczak v. Nat'l Beverage Corp.*, 400 F. Supp. 3d 1318, 1331 (S.D. Fla. 2019). The Eleventh Circuit rejected this reasoning, holding that it was too narrow a reading of the letter and that it failed to consider relevant background: the previous letters between the SEC and the defendant-company, as well as the subsequent Wall Street Journal article.

The *Luczak* Court highlighted the following line in the *Wall Street Journal* article in its analysis: "In correspondence with the agency disclosed in those filings, [the defendant-company] declined to provide the requested figures." *Luczak*, 812 Fed. Appx. at 923. The article did not specify which filings contained this information, leading the Eleventh Circuit to hold that the information could have been gleaned from sources other than the correspondence between the SEC and the defendant-company. As such, the article was not merely a summary of the publicly-available letters. Thus, when assessed cumulatively, the letter and the article provided "the market with a full realization that Defendants' claims . . . were misleading." *Id.* at 922.

In contrast, a news article that only "repackaged" publicly available filings, when submitted as the only corrective disclosure to an allegedly misleading statement, is insufficient to sustain an allegation of loss causation. *Id.* at 925-26. The Eleventh Circuit in *Luczak* assessed another *Wall Street Journal* article that allegedly notified investors for the first time of court pleadings that revealed that the defendant-company's most senior officer was accused of sexual misconduct. Determinative in the court's analysis was the fact that "the pleadings mentioned in the [*Wall Street Journal*] article were publicly accessible on the date of the article's publication." *Id.* at 926. As such, the article, standing alone, could not be a corrective disclosure. It simply did not "present facts to the market that are new, that is, publicly revealed for the first time." *Id.* (quotation omitted).

These decisions provide guidance regarding whether a disclosure (or partial disclosure) based on publicly-available information can be considered corrective. Courts analyze whether the disclosure provided information that was revealed to the market for the first time. Courts may also assess whether the disclosure provided a specialized analysis of public information, using skills that an ordinary market participant would not possess. In addition, the Ninth Circuit decision in *BofI* reflects that to analyze an alleged corrective disclosure, courts may distinguish between information that is *accessible* by the public, such as that which can be sought thorough a FOIA request, and information that is *available* to the public, such as that which is requested and produced pursuant to a FOIA request.

V. Cutting Edge Class Certification Issues in Securities Cases

Reliance is often a key issue at the class certification stage in securities cases. Whether an investor actually relied on an alleged false or misleading statement is an individualized issue that would preclude class certification, but courts have developed two potential presumptions of reliance that can sometimes relieve plaintiffs of having to prove actual reliance. The fraud-on-the-market presumption provides that in an efficient market where material information is rapidly incorporated into a company's stock price, reliance can be presumed for all members of the putative class. In addition, the Supreme Court also established the so-called *Affiliated Ute* presumption in 1972, whereby reliance can be presumed in certain circumstances regarding the omission of material facts. Key issues related to these presumptions are being litigated, and we expect further important decisions in 2021.

In *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258 (2014), referred to as *Halliburton II*, the Supreme Court held that defendants may rebut the fraud-on-the-market presumption of reliance at the class certification stage by showing that the alleged misrepresentations did not impact the stock price. There were two significant Court of Appeals opinions on price impact in 2020, one of which the Supreme Court has decided to review in 2021.

In *Arkansas Teacher Retirement System v. Goldman Sachs Group, Inc.*, 955 F.3d 254 (2d Cir. 2020), the plaintiffs challenged Goldman Sachs's generic statements regarding conflicts of interest. Although Goldman's stock price did not increase when the challenged statements were made, plaintiffs relied on a price maintenance theory, where they contended that the false statements maintained an inflated stock price by preventing a decline. The district court certified a class and concluded that Goldman failed to rebut the fraud-on-the market presumption because the court found a link between Goldman's statements and later stock price declines in connection with corrective disclosures.

On appeal, the Second Circuit held false statements under the maintenance theory "have price impact not because they introduce inflation into a share price, but because the 'maintain' it." It further held that such statements can be actionable even if the original price inflation was not related to fraud. Moreover, even generic statements such as Goldman's can maintain an inflated stock price for purposes of class certification because, in the Second Circuit's view, considering a statement's generic nature at the class certification stage would constitute an improper merits inquiry into the statement's materiality. The court affirmed class certification upon finding that Goldman had failed to prove a lack of price impact by a preponderance of the evidence. Under the inflation maintenance theory that the Second Circuit endorsed, an absence of price movement when an alleged misrepresentation is made does not demonstrate a lack of price impact.

The Supreme Court has decided to review the Second Circuit's decision in 2021. The Court's decision will hopefully provide clarity on exactly how defendants can rebut the fraud-on-the-market presumption at the class certification stage following *Halliburton II*.

In *In re Allstate Corporation Securities Litigation*, 966 F.3d 595 (7th Cir. 2020), the Seventh Circuit took a different approach than the Second Circuit when it vacated the district court's ruling certifying a class. The opinion shows continued tension with how lower courts struggle to apply the Supreme Court's twin commands to (i) avoid merits inquiries such as materiality at the class certification stage, and (ii) permit defendants to rebut the fraud-on-the-market presumption by showing a lack of price impact, an inquiry which often overlaps with merits issues. The district court had declined to consider the defendants' price impact evidence because it bore on materiality and loss causation. The Seventh Circuit, however, held that district courts "*must* consider the same evidence if the defense offers it to show the absence of . . . price impact." There is often significant overlap among the facts and arguments relevant to materiality, loss causation, and reliance. Materiality and loss causation cannot be decided at the class certification stage, but reliance—and therefore price impact—must be addressed. *Allstate* clarifies that district courts should not refuse to consider evidence that is probative of price impact just because it also relates to other elements of the plaintiff's claim. The Supreme Court's expected opinion in *Goldman* should also provide additional clarity in this area.

The Ninth Circuit is also slated to weigh in on the *Affiliated Ute* presumption as we head into 2021. In *In re Volkswagen "Clean Diesel" Marketing Sales Practices, and Products Liability Litigation*, No. 20-15564 (9th Cir.), the court will address the often-litigated issue of whether the *Affiliated Ute* presumption can apply in a securities case alleging both affirmative misstatements and material omissions. Most courts only apply the presumption when there is no allegedly misleading affirmative statement (so-called "pure omission cases"), whereas others apply it to claims based "primarily" on omissions. *Volkswagen* involves affirmative statements that are allegedly misleading by omission. The court's decision whether the *Affiliated Ute* presumption is applicable in those circumstances will significantly affect how easy or difficult it will be for plaintiffs in the Ninth Circuit to invoke the presumption. A decision in favor of the plaintiffs would make it much more difficult for defendants in most securities cases to obtain early dismissal or defeat class certification, as plaintiffs' lawyers typically argue that a defendant's statements were misleading by omission.

VI. Trends in Shareholder Derivative Litigation

DELAWARE SUPREME COURT LIMITS DEFENSES TO BOOKS AND RECORDS DEMANDS

Section 220 of Delaware General Corporation Law (8 Del. C. § 220) allows a shareholder to inspect corporate books and records "for any proper purpose." Shareholders considering derivative suits often invoke Section 220 to access company records pre-suit and use information from those documents to strengthen allegations in the complaint.

In *AmerisourceBergen Corp. v. Lebanon Cnty. Emps.' Ret. Fund*, 2020 WL 7266362 (Del. Dec. 10, 2020), the Delaware Supreme Court addressed a few recurring issues regarding Section 220 demands. The court held that a shareholder generally does not need to "specify the ends to which it might use the books and records." The court further held that when a shareholder seeks documents to investigate or pursue litigation, it need not show that the suspected "wrongdoing or mismanagement is actionable." The shareholder generally must show only "a credible basis from which the court can infer there is 'possible mismanagement that would warrant further investigation.'" While "a purely procedural" roadblock to litigation such as a lack of standing or the statute of limitations might justify denial of a demand for inspection solely for the purpose of pursuing litigation, the court clarified that issues going to the merits of the potential claims would not be considered.

The *AmerisourceBergen* case forecloses some of the objections corporations often make to books and records inspections, suggesting that shareholder plaintiffs will have greater success in obtaining company records to pursue derivative claims.

DIRECTOR FAILURE OF OVERSIGHT CLAIMS: FOCUS ON "MISSION CRITICAL" COMPLIANCE RISKS

A claim that corporate directors breached their duty to exercise compliance oversight is commonly referred to as a Caremark claim in reference to *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996). To sustain a *Caremark* claim, a plaintiff must generally plead particularized facts showing a majority of the board acted in bad faith through (1) an "utter failure to attempt to assure a reasonable information and reporting system exists" or (2) a "conscious failure" to monitor those systems and address "red flags" of compliance failures. *Caremark* claims are commonly dismissed at the pleadings stage for failure to meet this stringent standard, but remain a common feature of derivative lawsuits brought by shareholders after a regulatory enforcement action or other corporate crisis.

In the *Marchand* case in 2019, the Delaware Supreme Court reversed the dismissal of *Caremark* claims brought against Blue Bell directors and officers after listeria was detected in certain Blue Bell products, resulting in various harms to the company. The court characterized food safety as "essential and mission critical" to Blue Bell's success and emphasized the importance of the board's oversight responsibility in that area. The decision did not represent a substantive change to Delaware law, but *Marchand* and other decisions that followed suggested that courts might more closely examine board oversight efforts with respect to "mission critical" compliance aspects of the business.

Cases in 2020 reflect that Marchand has not marked a significant change in the overall success of *Caremark* claims as Delaware courts continue to dismiss these claims with regularity. In *McElrath v. Kalanick*, 224 A.3d 982 (Del. 2020), the Delaware Supreme Court affirmed dismissal of *Caremark* claims brought against Uber directors after Uber settled trade secret misappropriation claims for consideration valued at $245 million. In *Shabbouei v. Potdevin*, 2020 WL 1609177 (Del. Ch. Apr. 2, 2020), the Delaware Chancery Court dismissed claims against the board of Lululemon in connection with purported misconduct by the CEO. In both cases, the courts found that far from showing bad faith, the plaintiffs' allegations reflected good-faith efforts by the directors to fulfill their oversight duties.

In *Owens v. Mayleben*, 2020 WL 748023 (Del. Ch. Feb. 13, 2020), the Delaware Chancery Court dismissed Caremark claims brought against directors and officers of Esperion Therapeutics related to a press release regarding FDA approval of the company's lead cholesterol drug. And in *In re GoPro, Inc.*, 2020 WL 2036602 (Del. Ch. Apr. 28, 2020), the court dismissed *Caremark* claims after setbacks in a new product launch allegedly caused GoPro to fall short of revenue projections. The court in both instances held the plaintiffs failed to allege particularized facts showing that the directors knew or ignored "red flags" indicating that statements made to the public were false or misleading.

In *In re MetLife Inc. Derivative Litig.*, 2020 WL 4746635 (Del. Ch. Aug. 17, 2020), the Delaware Chancery Court dismissed Caremark claims against MetLife for compliance issues within its pension risk transfer business. While the plaintiffs alleged the board became aware of compliance weaknesses in that business segment before regulators initiated enforcement actions, the court held that in context, the board's failure to take immediate corrective action did not support an inference of bad faith.

While plaintiffs continued to struggle to gain traction with *Caremark* claims in Delaware courts, there were two cases of note where the Delaware Chancery Court permitted *Caremark* claims to proceed beyond the pleadings stage. Both relied heavily on *Marchand*.

In *Teamsters Local 443 Health Services & Ins. Plan v. Chou*, 2020 WL 5028065 (Del. Ch. Aug. 24, 2020), shareholders brought Caremark claims against directors and officers of AmeriSourceBergen relating to criminal charges and civil penalties levied against a subsidiary for improper sale of oncology drugs. The court held that plaintiffs pled particularized allegations of fact showing a majority of the board faced a substantial likelihood of liability for failure to make good-faith efforts to address compliance "red flags." Citing *Marchand*, the court held compliance with health and safety laws represented a "mission critical compliance risk," requiring due attention from the board. The court then examined detailed allegations made by the plaintiffs about a report prepared by an outside law firm and presented to the board indicating compliance weaknesses within the subsidiary at issue before regulatory violations came to light, and took account of plaintiffs' allegations about the absence of follow-up reports addressing those issues in board documents produced in response to the plaintiff's books and records demand. The court stated that the report "served as a red flag that [certain] mission critical compliance mechanisms . . . had substantial gaps" and "a backdrop against which the other pled red flags must be viewed." The court further determined that a qui tam action brought in 2010 by a former executive of the subsidiary and disclosed in SEC filings served as a "red flag" and the alleged absence of board action to remedy compliance failures further supported an inference of bad faith. While the defendants pointed to documents they believed showed the board tried to address the issues, such as board minutes reflecting discussion of the qui tam suit, the court found the documents to be ambiguous and "at most giv[ing] rise to multiple inferences, and at this pleading stage that means the Plaintiffs receive the inference." Finally, the court found the plaintiffs adequately alleged that a subpoena from the Department of Justice in 2012 identified in the company's SEC filings served as another "red flag" that went ignored. The court held that the plaintiffs were "entitled to the inference that the Board never discussed the subpoena due to its absence from the Board's minutes."

In *Hughes v. Xiaoming Hu*, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020), a shareholder brought *Caremark* claims alleging the defendants willfully failed to maintain an adequate system of internal controls for financial reporting and related-party transactions. In 2014, the company disclosed material weaknesses in its financial reporting and oversight systems. In 2017, the company made similar disclosures after the company was forced to issue restated financial statements from the previous three years. The court held that the plaintiff met the heightened pleading requirements for a claim under *Caremark*. Plaintiffs cited internal board documents to plead directors on the audit committee gave inadequate attention to their oversight duties and overlooked the weaknesses in internal controls identified in the 2014 disclosure. As an example, the court discussed allegations about an audit committee meeting in May 2014 where the committee purportedly reviewed certain agreements for related-party transactions, but "[n]either the agreements nor the review procedures were produced in response to the plaintiff's demand for books and records, supporting a reasonable inference that they either did not exist or did not impose meaningful restrictions on the Company's insiders." The court identified another meeting three weeks later where the audit committee purportedly reviewed and approved a new policy governing related-party transactions, but the policy was not turned over to plaintiffs, which "support[ed] a reasonable inference that it too either did not exist or did not impose meaningful restrictions on the Company's insiders." The plaintiffs identified various other instances where the audit committee purported to meet to approve policies and transactions, but the documents referenced in minutes did not exist or the meetings were so short that no meaningful discussion or action could have been accomplished. The court noted that while "the Company had the trappings of oversight, including an Audit Committee, a Chief Financial Officer, an internal audit department, a code of ethics, and an independent auditor," the plaintiffs' allegations showed an inactive board that "did not make a good faith effort to do their jobs."

There are two important takeaways from these two cases. First, based on *Marchand*, courts evaluating *Caremark* claims may take a closer look at how the board exercises oversight for "mission critical" aspects of the business. Second, both *Chou* and *Hu* state that if a company does not have a document that the company "would reasonably be expected to possess if a particular event had occurred," this could give rise under certain circumstances "to a reasonable inference that the event did not occur." Because shareholder plaintiffs often use books and records requests to meet their pleading burden, boards should ensure not only that reporting and monitoring systems for central compliance risks are in place, but also that they are well-documented and that board documents, especially board minutes, clearly reflect board discussion, action, and follow-up on compliance issues that rise to the board-level.

SHAREHOLDER LITIGATION ON SOCIAL JUSTICE ISSUES

A new trend emerging in shareholder litigation is the use of derivative suits to advance social justice and policy issues. This area of shareholder litigation saw several developments in 2020, particularly with respect to the "#MeToo" movement. Shareholder #MeToo lawsuits typically allege the board failed to properly exercise oversight with respect to workplace behavior or violations of internal codes of conduct, evidenced by instances of sexual harassment or other misconduct within the company that become the subject of public attention.

For example, Google's parent company, Alphabet, agreed to settle derivative suits filed in California and Delaware alleging that the board concealed wrongdoing by high-level executives and allowed a "male-dominated culture." The derivative suits were filed after reports were published in the New York Times and other media outlets about accusations of sexual misconduct within the company. Before the settlement, Alphabet's board formed a special committee to investigate the shareholders' allegations. After its investigation, the special committee recommended that the parties engage in mediation, which resulted in a comprehensive settlement agreement. Through the settlement agreement, Alphabet committed to establish a set of policies to achieve greater diversity and respect within the company (referred to as the Workplace Initiative), reform employment policies and practices, and institute certain corporate governance measures. Alphabet also agreed to set aside $310 million over 10 years to fund the Workplace Initiative measures.

Wynn Resorts finalized a settlement of a derivative suit relating to alleged sexual misconduct by founder Stephen Wynn reported in the *Wall Street Journal*. According to the court, this was the first derivative suit involving these types of allegations to survive a motion to dismiss on demand futility grounds. The settlement agreement called for a $41 million settlement payment to the company, including $20 million from Stephen Wynn personally, and initiatives to strengthen board diversity along with other corporate governance reforms valued at approximately $50 million.

Shareholders also brought a derivative suit against Victoria's Secret parent company, L-Brands, after a report in the *New York Times.* The shareholders alleged the board permitted executives to create a "toxic culture" and engage in sexual harassment. The L-Brands board formed a special committee to investigate the allegations, and the case is stayed pending that investigation.

Board diversity was also a topic of focus in 2020. Two plaintiffs' firms filed a series of derivative lawsuits against several companies (including Monster Beverage, Oracle, Facebook, NortonLifeLock, The Gap, and Danaher Corporation) for the alleged lack of diversity on their boards and in their workforces, targeting specifically companies purportedly without representation of a Black director. The plaintiffs allege that the existing boards have breached their fiduciary duties of care and oversight given these failures and have also caused their companies to issue false and misleading statements in proxy solicitations about their commitment to diversity. These cases are still in their early stages, but in almost all these cases, the defendants have filed a motion to dismiss on demand futility grounds or stated an intention do so soon.

Relatedly, in October, California passed a law requiring corporate boards of public companies with headquarters in California to have at least one board member that is "an individual who self-identifies as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual, or transgender." Boards with five to eight members must have two or more directors from these communities by 2021, and boards with nine members must have three or more. This comes after California's passage of a similar law in 2018 requiring representation by at least one woman director by the end of 2019. Failure to comply with these laws can result in hefty fines, not to mention negative publicity.

Generally, California-based companies have chosen not to challenge these new laws. Challenges brought by outside legal groups have met mixed results. A suit in federal court brought by a shareholder of a company with an all-male board that challenged the 2018 law on equal protection grounds was dismissed for lack of standing as the shareholder was unable to identify any particularized injury or harm he experienced as a result of the law. An appeal of that decision is pending in the Ninth Circuit. Another lawsuit brought by three California citizens (supported by conservative legal groups) in California state court on state law grounds survived a motion to dismiss and will move forward. These same plaintiffs filed a very similar lawsuit challenging the latest board diversity law shortly after it was passed.

The recent national focus and attention on social justice issues will undoubtedly continue to spill over into shareholder litigation for the foreseeable future.

VII. SEC Enforcement Update

STATUTORY DEVELOPMENTS ADDRESSING THE SUPREME COURT'S RECENT DECISIONS REGARDING SEC DISGORGEMENT

The SEC has routinely sought disgorgement (such as the return of profits illegally obtained) in actions alleging securities law violations. Until recently, it has been considered an equitable remedy, available to the SEC under a general authority to seek equitable relief in civil proceedings. *See Liu v. SEC*, 140 S. Ct. 1936, 1940 (2020) (citing 15 U.S.C. § 78u(d)(5)). But as of January 1, 2021, with the passing of the National Defense Authorization Act for Fiscal Year 2021, disgorgement has been codified into a form of statutory relief. The inclusion of a provision regarding disgorgement in the Act was likely a result of the SEC's efforts to persuade Congress to address two key Supreme Court decisions through legislation.

In June 2020, the Supreme Court decided *Liu v. SEC*, a decision in which it upheld the SEC's ability to pursue disgorgement but noted that, as an equitable remedy, it was subject to certain restrictions. 140 S. Ct. at 1936. The Court limited the SEC's disgorgement ability to only the net income or net profit generated from the violative conduct, thus allowing defendants to offset legitimate expenses from a disgorgement calculation. *Id.* at 1947. The *Liu* Court further held that disgorgement must be for the benefit of investors, rather than for payment to the U.S. Treasury. *Id.* at 1948-49.

The Supreme Court has previously applied restrictions to the SEC's ability to seek disgorgement as an equitable remedy. In *Kokesh v. SEC*, the Supreme Court unanimously held that claims for disgorgement brought by the SEC were punitive and, thus, subject to a five-year statute of limitations. 137 S. Ct. 1635, 1638-39 (2017). The SEC claimed that it was not a penalty subject to the five-year statute of limitations under 28 U.S.C. § 2462. The Court disagreed with the SEC's approach and prevented the SEC's ability to pursue disgorgement for conduct more than five years before the filing of the SEC's enforcement action. *Id.*

In what appears to be a direct result of the SEC's effort to restrict the scope of these decisions, a short securities-related provision was included in the National Defense Authorization Act for Fiscal Year 2021, a lengthy bill that otherwise primarily addresses Department of Defense spending. Congress granted express authority to the SEC to seek disgorgement. As a result, the SEC Enforcement Division now has the go-ahead to pursue up to ten years of disgorgement in cases that require the SEC to prove intentional misconduct. The legislation applies to any action or proceeding that is pending on or commenced after its enactment, so will apply retroactively, to actions that have not been fully resolved with the SEC. The passage of this legislation does not change the five-year limitations period under 28 U.S.C. § 2462; rather, it clarifies that this limitations period does not apply to the SEC's ability to seek disgorgement.

Where we once anticipated lower disgorgement figures, we anticipate this statutory development will lead to increased disgorgement calculations by the SEC in enforcement matters. Also, because the SEC typically seeks prejudgment interest in enforcement matters, calculated and compounded quarterly, tremendous interest charges could further expand the monetary expectations in litigated and settled actions with the SEC. It is unclear whether the restrictions imposed in the *Liu* decision—such as the need for disgorgement to be a remedy to benefit investors and the requirement that disgorgement be reduced by legitimate expenses—will remain intact. Much of that will be determined in litigation as the SEC flexes its disgorgement powers.

PANDEMIC-RELATED ENFORCEMENT AND OTHER UPDATES

As with many other areas of the law, the SEC enforcement space was impacted this year by the pandemic and related investor issues. In April, the SEC formed a cross-divisional COVID-19 Market Monitoring Group tasked with analyzing the effects of COVID-19 on markets, issuers, and investors. The Monitoring Group has spearheaded the Commission's coordination with other federal agencies and undertaken a campaign of public education, including issuing an Investor Alert detailing common pandemic-related frauds. Additionally, as of December 16, 2020, the SEC had suspended trading in 37 stocks in connection with COVID-19.

Enforcement actions in the COVID era have focused primarily on misrepresentations regarding the development of technology used to detect the virus and, more recently, on misleading disclosures regarding the effect of the pandemic on a company's business operations and financial condition. Several of these actions involved allegations of false and misleading representations related to the development of rapid COVID-19 testing technology: *SEC v. Turbo Global et al.* (May 14, 2020), *SEC v. Applied Bioscience* (May 14, 2020), *SEC v. Nielson* (June 9, 2020), SEC v. Schena (Sep. 25, 2020), *SEC v. Berman* (Dec. 17, 2020). The SEC also recently announced settled charges against The Cheesecake Factory—its first (and so far only) action involving insufficient disclosure of the current and future material impacts of the pandemic on a company's operations and financial condition. The language of the complaint in that action could signal heightened scrutiny from the Commission of overly rosy glosses on the pandemic's effects on a company's business operations.

Aside from its response to the pandemic, the SEC's Enforcement Division continued its emphasis on individual liability in its fiscal year 2020, charging individuals in over 72% of its standalone actions. The whistleblower program also continued to grow with another record year in 2020. The program awarded over $175 million to 39 individuals, including a milestone award of $114 million to a single whistleblower. The second-highest individual award ever, $50 million, was awarded in fiscal 2020 as well.

The Commission also updated its Foreign Corrupt Practices Act resource guide—a joint publication with the Department of Justice first released in 2012. The updated guide addresses changes to the legal landscape due to U.S. Supreme Court decisions (including the *Liu v. SEC* decision discussed above) and the development of enforcement policy since its initial release.

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