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Securities Cases Plaintiffs Attorneys Must Watch In 2019

By **S. Douglas Bunch and Alice Buttrick** (January 1, 2019)

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A basic premise of the federal securities laws is that investors are entitled to trust the veracity of a company's public statements. In 2018, defendants in three key securities cases made novel attacks on the idea that corporations and corporate speakers are responsible for the accuracy of the statements they make to the investing public. From the plaintiff's perspective, these tactics appear to be inspired by the "post-truth" era we have entered in the political realm, where facts are increasingly disregarded.

In re Goldman Sachs Group

In Arkansas Teachers Retirement System v. Goldman Sachs Group,[1] the defendants seek to invert the logic of Halliburton Co. v. Erica P. John Fund Inc.[2] (Halliburton II), which permits defendants to rebut the Basic "fraud-on-the-market" presumption with, among other things, evidence that the challenged misstatements did not impact the stock price. The result could effectively immunize certain types of material misstatements, namely those pertaining to corporate governance.

The plaintiffs in the case allege that Goldman Sachs made false statements regarding its comprehensive conflict management and avoidance processes, and that its stock sold at a premium because of its reputation for such strong corporate governance. Goldman Sachs failed to disclose, however, that it had acted in direct conflict with its clients in several transactions during the same period. When U.S. Securities and Exchange Commission and U.S. Department of Justice enforcement actions based on those conflicts were disclosed, Goldman's stock dropped.

The Second Circuit recently granted the defendants the opportunity to file a second interlocutory appeal of class certification. In their motion seeking leave to appeal, which will likely track their appellate arguments, the defendants predictably challenge the adequacy of the district court's factual findings. But the defendants' primary argument is that they should not have been required to put forth evidence of price impact at all, because the misstatements alleged are too vague and general to support the plaintiffs' "price maintenance" theory of loss causation.

The defendants' argument is an attempt to relitigate whether the alleged misstatements are "material," an issue already decided against them when their motions to dismiss were denied, and which does not bear on whether class certification should be granted. The defendants' argument also attempts to shift onto the plaintiffs their burden of proof that the elements of the Basic presumption are not met. In Halliburton II, however, the U.S. Supreme Court expressly recognized that plaintiffs do not have an obligation to prove materiality before class certification; instead, assuming the adequacy of plaintiffs' allegations, Halliburton II merely permits defendants an opportunity to rebut the elements of the Basic presumption.

Even as a materiality argument, the defendants' position falls short. The notion that statements pertaining to general policies cannot provide the basis for a price maintenance theory, moreover, is consistent with some defendants' desire to pay lip service to the corporate governance protections that investors expect and demand, without having any intention of delivering on those promises.

Lorenzo v. SEC

The defendant in Lorenzo v. SEC[3] argues that he cannot be held directly liable for false statements he knowingly emailed to investors with the intention of inducing investment because his boss retained the "ultimate authority" over the statements' contents. Lorenzo's position would significantly narrow the ability of private plaintiffs to bring securities fraud claims against individuals who knowingly endorse and distribute false statements.

The D.C. Circuit held that Lorenzo knew the statements were false when he sent them and determined, under a narrow reading of Janus Capital Group Inc. v. First Derivative Traders,[4] that Lorenzo did not "make" the statements pursuant to Rule 10b-5(b), because his boss retained the "ultimate authority" over the emails. Ultimately, however, the court concluded, over then-Judge Brett Kavanaugh's dissent, that Lorenzo could nevertheless be subject to scheme liability for his conduct under Rules 10-b5(a) and (c) and Section 17(a), none of which turn on whether the defendant is the "maker" of the statement at issue.

At the Supreme Court argument, held on Dec. 3, several justices appeared skeptical that Janus could cabin the plain language of Rules 10b-5(a) or (c), or Section 17(a). Crucially, Francis Lorenzo suggested that his role in the dissemination of the emails was too minor to incur primary liability, in part because his conduct wasn't sufficient to constitute the "substantial assistance" required for secondary aiding-and-abetting liability. But the prior Supreme Court precedent distinguishing between primary and secondary liability, and precluding private plaintiffs from pursuing the latter, turned on the fact that private plaintiffs could not demonstrate the reliance necessary to support aiding-and-abetting claims. Lorenzo sent false statements directly to potential investors under his own name, inducing those investors to rely on his own reputation as an assurance that the content was correct. That Lorenzo may have played a minimal role in drafting the email's contents may have some implications for scienter (which he does not contest) but has no effect on whether the investors relied on his own conduct, rather than somebody else's.

Shifting the dividing line between primary and secondary liability away from the guiding principle of investor reliance could create significant obstacles for investors, who reasonably assume that a professional who sends and signs a statement regarding securities is taking responsibility for its contents. And limiting primary liability to a single "maker" with the ultimate authority over a statement could immunize the knowing dissemination or advertisement of a false statement "made" by a subordinate whose supervisor lacked scienter.

First Solar

In First Solar Inc. v. Mineworks Pension Scheme,[5] for which a petition for certiorari is pending, the defendants argue that they cannot be held liable for losses caused by the revelation of the effects of their fraudulently concealed conduct until the fact of the fraud itself is also disclosed.

The plaintiffs in this case argue that their loss was caused, in part, by the market reaction to poor earnings statements that incorporated the costs of the concealed product defects. The defendants contend that their fraudulent concealment of the defects could not have caused the plaintiffs' losses because the market was only reacting to the economic effects of the undisclosed defects, without knowing that any conduct had been fraudulently concealed. The Ninth Circuit, applying a standard proximate cause analysis, determined that revelations of the fraud's effect were sufficient to demonstrate loss causation and affirmed the denial of summary judgment.

Dura Pharmaceuticals Inc. v. Broudo,[6] makes clear that the proper standard for assessing the loss causation element of a Section 10(b) claim is proximate cause. And the defendants do not contest that the plaintiffs put forward evidence that the earnings statements, rather than other intervening causes, reflected the defendants' fraudulently concealed conduct and caused the decline in stock price that harmed them.

Nevertheless, the defendants claim that the market must specifically learn about the fraudulent nature of their conduct in order to demonstrate loss causation — that is, the defendants argue that investors are not harmed by their fraudulent misstatements unless the investors know that their injury is being caused by a fraud. That position would give defendants a road map for drastically narrowing the potential damages resulting from securities fraud; as the defendants did here, corporations would be incentivized to reveal the economic impact of their fraud, allow the market to react, and then face liability only for the losses incurred after the concealed conduct itself was admitted, which might amount to a mere fraction of the overall loss.

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Each of the arguments highlighted above, if successful, would make it more difficult for investors to rely on the accuracy of corporate representations and hold defendants accountable for deliberately misleading the public. In 2019, we anticipate that some defendants, emboldened by a clearly corporation-friendly Supreme Court, will continue their creative efforts to evade responsibility for their actions.

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Disclosure: Cohen Milstein submitted an amicus brief on behalf of the North American Securities Administrators Association Inc. in Lorenzo v. SEC.

[1] Arkansas Teachers Retirement System v. Goldman Sachs Group, No. 18-2557 (2d Cir.).

[2] Halliburton Co. v. Erica P. John Fund Inc., 573 U.S. --, 134 S. Ct. 2398 (2014).

[3] Lorenzo v. SEC, No. 17-077 (U.S.).

[4] Janus Capital Group Inc. v. First Derivative Traders, 564 U.S. 135 (2011).

[5] First Solar Inc. v. Mineworks Pension Scheme, No. 18-164 (U.S.) (cert. petition pending).

[6] Dura Pharmaceuticals Inc. v. Broudo, 544 U.S. 366 (2005).

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