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## Congress Considers Laws to Curb Insider Trading

Company executives and officers continue to profit on their inside knowledge despite existing restrictions. 



# Congress Considers Laws to Curb Insider Trading

Securities laws and regulations exist, in part, to make sure securities trade on a level playing field where all investors have access to the same company information at the same time. But while it is unlawful for corporate insiders to trade securities based on nonpublic information, there is plenty of evidence that company executives and officers continue to profit on their inside knowledge despite existing restrictions.

The current Congress is considering several measures to close such loopholes. One of these laws, which would tighten the rules governing prearranged trading plans, is awaiting Senate action after overwhelming approval in the House. Another would end what its sponsor called "decades of ambiguity" by expressly making it a federal crime to trade on wrongfully obtained non-public information.

Here is a brief update of where these bills stand in the legislative process, beginning with the one that is furthest along.


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**ALMOST FROM THE DAY RULE 10B5-1 TRADING PLANS WERE ESTABLISHED, THEY HAVE BEEN CRITICIZED AS SUSCEPTIBLE TO MANIPULATION BY CORPORATE INSIDERS. NOW CONGRESS IS CONSIDERING LEGISLATION THAT WOULD CLOSE LOOPHOLES IN THE RULES GOVERNING THESE PLANS.**

## The Promoting Transparent Standards for Corporate Insiders Act

This bill, which passed the House of Representatives with near-unanimous support, would direct the Securities and Exchange Commission to study changes to prevent manipulation of Rule 10b5-1 trading plans, which give corporate insiders an "affirmative defense" against allegations of unlawful insider trading.

Rule 10b5-1, enacted by the SEC in 2000 pursuant to its rule-making authority under the Securities Exchange Act of 1934, defines insider trading as the buying or selling of a security while in possession of "material nonpublic information" about that security or its issuer.

But SEC Rule 10b5-1 also shields insiders who become aware of nonpublic information after they decide to trade but before the trade is executed—who, in other words, don't base their decision on inside information. By setting up Rule 10b5-1 trading plans that instruct investment professionals to buy or sell stock in certain quantities at prearranged times, executives and board members can often avoid insider trading liability even if they profit from a trade's timing.

When the Department of Justice, the SEC, or private plaintiffs point to suspicious trading patterns by corporate insiders as evidence that they knew about a fraudulent scheme of which the public was unaware, these executives and officers often successfully present their use of trading plans as evidence to negate their liability—the affirmative defense ensconced in Rule 10b5-1.

Yet almost from the day Rule 10b5-1 trading plans were established, they have been criticized as susceptible to manipulation by corporate insiders. A 2016 study in the *Columbia Business Law Review*, for example, concluded that insiders often set up, modified, and discontinued plans to capitalize on nonpublic information. Its examination of more than 1.5 million insider transactions registered with the SEC from 2003 through 2013 found that insiders with plans in place profited as much as insiders without restrictions. "Our evidence clearly shows that these safe harbor plans are being abused to hide profitable trades made while in possession of material non-public information," its authors wrote.[i]

**TWO OF THE INSIDER TRADING BILLS BEFORE CONGRESS RECEIVED BI-PARTISAN SUPPORT IN THE HOUSE OF REPRESENTATIVES. WHETHER THEY PASS THE SENATE REMAINS TO BE SEEN.**

Looking to close such loopholes, the proposed bill would order the SEC to do a one-year study to determine whether the rule should be amended to allow plans to be established only during issuer-adopted trading windows, limit the ability of issuers and insiders to adopt multiple plans, and restrict how often plans can be modified or canceled. The SEC would be required to consider imposing mandatory delays between a plan's establishment or modification and the first prearranged trade.

In a rare display of high-level bipartisanship, the bill was co-sponsored by House Financial Services Committee Chairwoman Maxine Waters (D-Calif.) and Ranking Member Patrick McHenry (R-N.C.), and approved by a 413-to-3 vote on January 28, 2019. The Senate version of the bill was referred to the Committee on Banking, Housing and Urban Affairs.

## The Insider Trading Prohibition Act

Because there is no express definition of insider trading in the federal securities laws, it has become an example of "judge-made" law, with judges in each successive case relying on previous rulings to discern whether a defendant's behavior runs afoul of Section 10(b) of the Exchange Act. The Insider Trading Prohibition Act introduced by Rep. Jim Himes (D-Conn.) seeks to codify the law of insider trading.

In Himes' words, the Act "would make it a federal crime to trade a security based on material, nonpublic information that was wrongly obtained, ending decades of ambiguity for a crime that has never been clearly defined by the law."

The Insider Trading Prohibition Act goes beyond the individual who trades on insider knowledge. It would make it unlawful to communicate an inside "tip" to someone who may be reasonably expected to trade on it. It defines as wrongful any information obtained through "theft, bribery, misrepresentation or espionage," in violation of computer data privacy laws, intellectual property laws, or breaches of fiduciary duty or confidentiality.

i *See* Taylan Mavruk and H. Nejat Seyhun, "Do SEC's 10B5-1 Safe Harbor Rules Need To Be Rewritten?," *Columbia Business Law Review*, Vol 2016, pp. 182-183, and H. Nejat Seyhun and Taylan Mavruk, "SEC Needs to Rewrite its 10b5-1 Safe Harbor Rules," The CLS Blue Sky Blog, June 2, 2016.

Importantly, the bill would also remove a requirement in some jurisdictions that the "tippee" know that the "tipper" received a personal benefit from sharing the information, as long as the tippee knew or recklessly disregarded that the information was wrongfully obtained. In Congressional testimony in support of the bill, Columbia Law School Professor John C. Coffee, Jr. called the requirement of showing a benefit to the tipper "a significant barrier to insider trading enforcement" because it is easy to hide and because Wall Street essentially runs on favors. (Coffee serves on a task force formed in October 2018 by former U.S. Attorney Preet Bharara to explore changes in insider trading laws. The task force includes former regulators, prosecutors, judges, academics, and defense lawyers. It has not yet released its report.)

Finally, the bill would authorize the SEC to use its discretion to exempt any individual or transaction from liability under it.

**THE INSIDER TRADING PROHIBITION ACT WOULD END WHAT ITS SPONSOR CALLED "DECADES OF AMBIGUITY" BY EXPRESSLY MAKING IT A FEDERAL CRIME TO TRADE ON WRONGFULLY OBTAINED NON-PUBLIC INFORMATION.**

The House Financial Services Committee unanimously approved the measure, with vocal support from Reps. Waters and McHenry. It is awaiting consideration by the full House.

## The 8-K Trading Gap Act of 2019

Another loophole exploited by corporate insiders involves the four-day delay between the time a company learns of potentially market-moving information and the time it is required to report that information to the SEC (and thus the public) by filing a Form 8-K.

The so-called "8-K trading gap" was a term coined by current SEC Commissioner Robert J. Jackson, Jr. in a 2015 research paper he published while at Columbia Law School. Jackson and his co-authors concluded that "public-company insiders trade during the 8-K gap—and earn economically and statistically meaningful profits while doing so." [ii] His findings echoed a 2012 investigation by *The Wall Street Journal*, which similarly found "that many executives reaped robust gains when they traded ahead of major announcements." [iii]

The bill proposed by Rep. Carolyn Maloney (D-N.Y.) would amend the Exchange Act to require the SEC to eliminate the four-day gap with exceptions for certain transactions entitled to safe harbor protections, such as trades made under Rule 10b5-1 trading plans. The bill was discussed at an April 3 hearing of the House Financial Services Subcommittee on Investor Protection, Entrepreneurship and Capital Markets, which Maloney chairs.

ii *See Columbia Law and Economics Working Paper No. 524*, "The 8-K Trading Gap," Alma Cohen, Robert J. Jackson, Jr., and Joshua Mitts, September 7, 2015.

iii *See The Wall Street Journal*, "Executives' Good Luck in Trading Own Stock," by Susan Pulliam and Rob Barry, Nov. 27, 2012.

## Stock Buybacks

Research by SEC Commissioner Jackson may also prompt Congressional action on another common practice—heavy sales of company stock by executives following buyback announcements—that while not strictly insider trading, can allow them to profit handsomely.

In December 2018, Sen. Chris Van Hollen asked Jackson to clarify his research after SEC Chairman Jay Clayton commented to the Senate Banking Committee that Jackson's findings of larger-than-usual insider selling after buyback announcements could be coincidental. Maybe executives sell stock after buybacks, the thinking goes, because they are newly freed of company-imposed insider trading restrictions in place before the announcement, when the executives had possessed nonpublic information.

**SHARE PRICES TYPICALLY GO UP ONCE A COMPANY ANNOUNCES THAT IT PLANS TO REPURCHASE ITS OWN STOCK: A BUYBACK ANNOUNCEMENT IS ESSENTIALLY A DECLARATION THAT THE COMPANY THINKS THE STOCK IS TRADING CHEAPLY.**

Share prices typically go up once a company announces that it plans to repurchase its own stock: a buyback announcement is essentially a declaration that the company thinks the stock is trading cheaply; the buyback itself also takes shares off the open market, reducing supply. Swimming in extra cash following the 2017 tax cuts, corporations repurchased a record $806 billion of their own shares last year, according to figures compiled by S&P Dow Jones Indices. SEC rules currently provide a "safe harbor" that reduces liability when companies repurchase their own common stock on open markets.

In a March 2019 letter responding to Van Hollen, Jackson said additional research had shown higher-than-usual insider trading after buybacks regardless of company's pre-announcement trading restrictions. In his letter, Jackson also noted another "troubling trend." When insiders sell after a buyback announcement, the company's "long-term performance is worse," he said. "This raises the concern that insiders' stock-based pay gives them incentives to pursue buybacks that maximize their pay—but do not make sense for long-term investors."

Van Hollen said Jackson's findings showed "that corporate executives can use buybacks to cash out at high prices to the detriment of their company and investors." Van Hollen now plans to introduce a bill that would require the SEC to review its current buyback rules. ■

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# Allison H. Lee Fills Vacant Democratic Seat on SEC

Former longtime Securities and Exchange Commission attorney Allison Herren Lee has rejoined the regulatory agency as a Commissioner following her confirmation by the Senate in June. The addition of Lee, a Democrat, restores the Commission to full strength after six months with only four members.

Lee spent 13 years at the SEC, joining as enforcement counsel in 2005 and later serving as counsel to Commissioner Kara Stein, whose seat she is filling, and as senior counsel for the Enforcement Division's Complex Financial Instruments Unit. Before joining the SEC, Lee was a lawyer in private practice and a Special Assistant U.S. Attorney. She has written, lectured, and taught internationally since leaving in January 2018.

During her confirmation hearing, Lee underscored the importance of the SEC's mission to protect investors in an age where more Americans are responsible for their own retirement savings and must manage their own risk.

"The SEC works to ensure that investors are taking the kinds of risk they sign up for—business and economic risk—not the risk of fraud, and not the risk of poorly structured or opaque markets that may disadvantage investors," she said.

Lee was sworn in July 8 to a term expiring in 2022. Under SEC rules designed to encourage nonpartisanship, no more than two of five Commissioners can belong to the same political party. Commissioners, who serve five-year staggered terms, are appointed by the President and confirmed by the Senate. Presidents traditionally name someone of their own party as Chairman. At least three Commissioners must approve new measures.

It is unclear how long the Commission will retain its full complement after Lee's arrival. Democratic Commissioner Robert J. Jackson, Jr., who was appointed in January 2018 to fill a partial term, may step down as early as this year. It was widely hoped that Jackson, whose background in academic research has given him considerable influence and respect (see accompanying article), would be reappointed. It was reported in April, however, that he had accepted a job at New York University Law School, where the website now lists him as "on leave." When Jackson and Republican Commissioner Hester Peirce took their seats in January 2018, the SEC had been operating with three Commissioners for over a year.

# DETERRING CORPORATE RECKLESSNESS: A RESPONSE TO THE U.S. CHAMBER'S ATTACK ON "EVENT-DRIVEN" SECURITIES LITIGATION

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*Editor's Note: This article originally appeared on the Harvard Law School Forum on Corporate Governance and Financial Regulation at: https://corpgov.law.harvard.edu*

The purported mission of the U.S. Chamber of Commerce's Institute for Legal Reform ("ILR") is to bring about "civil justice reform" by, among other things, lobbying Congress to limit investors' access to the courthouse. For decades, the ILR has allied itself with powerful publicly traded corporations under the pretext of protecting their defrauded investors. The ILR's latest campaign, like so many of its previous endeavors, relies on the illogical premise that investors and the economy are harmed by securities fraud litigation rather than by corporate fraud and malfeasance. In two reports authored by Mayer Brown Partner Andrew Pincus, *A Rising Threat the New Class Action Racket that Harms Investors and the Economy* (October 2018) [1] and *Containing the Contagion, Proposals to Reform the Broken Securities Class Action System* (February 2019) [2], the ILR asserts that the 1995 Private Securities Litigation Reform Act ("PSLRA") has failed to curtail meritless securities lawsuits and that Congress therefore must place additional constraints on investors' ability to hold companies accountable for fraud.

Citing the increase in the number of securities-related lawsuits over the past several years, the ILR argues that courts should not be permitted to separate the meritorious cases from the weak and that certain types of cases must be scaled back through legislation. Both ILR reports specifically target federal securities class actions that: (i) challenge M&A transactions; and (ii) arise from corporate disasters. This article focuses only on the category of lawsuits the ILR calls "event-driven litigation."

The ILR insists that cases involving corporate disasters "*extort* large settlements" from corporations for meritless claims. That bold assertion conveniently ignores the fact that many cases of this type have settled only after hard-fought litigation in which the corporate defendants were vigorously represented by lawyers from the country's most elite law firms, making the ILR's efforts to victimize the companies even more of a distortion. Contrary to the ILR's claims, the existence of "event-driven litigation" simply reflects the reality that when companies behave recklessly, there often are two groups of victims: individuals who suffer personal or property injuries, and shareholders who sustain investment losses.

The ILR's assertion that the increase in event-driven litigation causes damage to investors and companies, rather than reflect it, is as fundamentally unsound as the idea that the number of firefighters dispatched to a fire causes greater fire damage. To the contrary, event-driven cases serve as a deterrent to companies who might otherwise conceal or misrepresent their operations because they recognize that investors will hold them accountable for doing so.

## "Event-Driven Litigation" Describes Almost Any Securities Fraud Action that Does Not Arise from an Accounting Restatement

So-called "event-driven litigation" describes cases in which a company recklessly concealed or misrepresented the risk of a major negative event, making statements touting its strong safety policies and procedures, for example, or its compliance with the law. When dangerous operations or illegal conduct are exposed—often because of a catastrophic event—the market reacts negatively and artificial inflation dissipates from the stock price, damaging investors who relied on the false or misleading statements. These cases are distinguishable from accounting fraud cases, where typically the company itself reveals internal misconduct. Recent examples of big accounting restatements include those announced by Valeant and American Realty Capital Properties, both of which resulted in criminal convictions of company executives.

However, high-profile securities fraud cases also arise from adverse events which reveal that a company has recklessly misrepresented its compliance with the law (*e.g.*, the *Petrobras* case discussed below) or the quality of its loans or underwriting practices (as in, for example, the mortgage-backed securities fraud cases against large Wall Street banks). In the past, allegations that a company had "cooked the books" were the primary basis for securities fraud actions. That no longer is the case, however. Since 2006, U.S. corporations have reduced the number of restatements by one-third, likely both because regulations have become more stringent and because executives have become more creative in concealing the truth. [3]

In fact, the ILR's contention that the only legitimate securities fraud claims are based on false financial reporting or accounting violations has twice been rejected by the Supreme Court, which has explicitly recognized that "an adverse event ... can be the basis for a securities fraud class action" (in *Matrixx Initiatives, Inc. v. Siracusano*, in 2011, and in *Omnicare Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, in 2015). And, the ILR's conclusion that so-called "event-driven" cases are somehow a problem requiring legislation is also belied by the numerous successful "event-driven" securities fraud cases that resulted in substantial recoveries for shareholders. For example, Brazilian state-owned energy company Petróleo Brasileiro S.A. ("Petrobras") paid more than $2.95 billion in 2018 to resolve private securities fraud claims based on its undisclosed illegal conduct.

In *Petrobas*, the plaintiff investors alleged that company executives organized a vast kickback and bid-rigging scheme which involved over a dozen companies and many of Brazil's leading political figures. Despite writing off nearly $20 billion, Petrobras never restated its financials. However, even without a financial restatement, the *Petrobras* district court observed that the concealment of an unlawful transaction can be considered a material misrepresentation, particularly where the massive asset write-down threatened the viability of the company. The court also found that Petrobras' representations concerning its integrity and high ethical standards were actionable under the federal securities laws because they were designed to reassure investors who relied on the statements' veracity and the company's stability.

**THE EXISTENCE OF "EVENT-DRIVEN LITIGATION" SIMPLY REFLECTS THE REALITY THAT WHEN COMPANIES BEHAVE RECKLESSLY, THERE OFTEN ARE TWO GROUPS OF VICTIMS: INDIVIDUALS WHO SUFFER PERSONAL OR PROPERTY INJURIES, AND SHAREHOLDERS WHO SUSTAIN INVESTMENT LOSSES.**

**EVENT-DRIVEN CASES SERVE AS A DETERRENT TO COMPANIES WHO MIGHT OTHERWISE CONCEAL OR MISREPRESENT THEIR OPERATIONS BECAUSE THEY RECOGNIZE THAT INVESTORS WILL HOLD THEM ACCOUNTABLE FOR DOING SO.**

The *Petrobras* case is merely one example of successful "event-driven" litigation; statistics show that of the 100 top securities fraud settlements of all time, 59% did not involve a restatement. *See* ISS, "The Top 100 U.S. Class Action Settlements of All-Time, as of 31 December 2017", at 33. Accordingly, 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.

## The Fact that a Company Faces Liability for an Underlying Event Doesn't Mean Its Investors Should Go Without Relief

The ILR also relies on circular logic to conclude that unexpected events are, by definition, unexpected. As a result, it contends, it would be unfair to assume that a company recklessly concealed the risk of a catastrophic event from investors. This argument too is belied by evidence uncovered in litigation against BP and in cases involving various mortgage-backed securities. Notably, that evidence would not have been discovered had plaintiffs' counsel not first been able to adequately plead claims that the courts found were sufficiently strong to withstand motions to dismiss.

The securities fraud class action against BP arose from the *Deepwater Horizon* explosion—the largest environmental disaster in U.S. history. Investors claimed that BP recklessly concealed the true likelihood of a catastrophic event. In that case, following a series of catastrophic events, BP repeatedly told investors that it would prioritize process safety through a state-of-the-art Operating Management System ("OMS") that the company would implement "across all of BP's operations." In discovery, investors learned that BP in fact had no intention of implementing OMS on contracted vessels, which were used for BP's most dangerous deep-sea drilling operations. Because BP contracted with Transocean, OMS did not apply to the *Deepwater Horizon*, which meant that BP did not have a viable Oil Spill Response Plan, as required by its frequently touted OMS. Thus, not only did BP fail to prevent a catastrophic event but then once the *Deepwater Horizon* explosion occurred, unbeknownst to its shareholders, BP did not have a plan in place to mitigate the disaster. [4]

BP settled the mass tort claims for $20 billion. However, its shareholders were able to credibly claim that they had been injured as a result of BP's misrepresentations regarding its safety systems. Although the district court denied plaintiffs' motion for class certification on those claims, the judge did permit investors to pursue fraud claims if they established they would not have purchased BP stock had they known the truth about the limited application of OMS. [5]

Likewise, there were more than a dozen mortgage-backed securities class action cases filed by private plaintiffs against Wall Street banks for knowingly misrepresenting their underwriting standards, resulting in AAA-rated bonds. The banks' misrepresentations about their increasingly lax underwriting standards contributed to the financial crisis by enabling unqualified borrowers to obtain mortgages. The banks then churned those poorly underwritten loans through mortgage-backed securities and other securitizations, which investors purchased before the securities plummeted in value in 2008. While *The Economist* estimates that from 2008 through October 2013, U.S. banks agreed to pay $95 billion in mortgage-related penalties, investors were also able to use private litigation to recoup some of the losses they sustained as a result of the banks' misrepresentations concerning their underwriting standards. As a result of these shareholder class actions, banks agreed to pay more than $3 billion in private settlements with classes of investors who purchased the mortgage-backed securities.

## Meritorious Securities Fraud Claims Ensure Truthful Corporate Statements and Accountability

As the cases discussed above illustrate, the ILR's assertion that congressional and regulatory action is needed to curb "abusive" securities class actions because such cases "are imposing huge costs on investors without providing any benefit" is wholly unfounded. Moreover, the importance of private securities fraud actions is underscored by the fact that, from 2006 through 2018, securities class actions have generated more than $101 billion in investor recoveries. [6] Overall, the monies recovered for investors through private class actions dwarf the monies investors have recovered through SEC disgorgements, the top 50 of which collectively total less than $11 billion. [7] In addition, the ILR's contention that shareholder litigation is a costly and indiscriminate drain on businesses is belied by the facts. A recent statistical analysis, for example, found that "[e]xposure of public corporations to alleged violations of the federal securities laws under Section 10(b) and 20(a) of the Securities Exchange Act of 1934 is approximately one quarter of a percentage point of the aggregate market capitalization of U.S.-based corporations." [8]

**AS THE ILR'S OWN STATISTICAL DATA REGARDING DISMISSAL RATES SHOWS, COURTS ARE MORE THAN CAPABLE OF WEEDING OUT THE WEAK CASES FROM THE STRONG AND, AS HISTORIC MEGA-SETTLEMENTS SHOW, THE STRONG ONES SHOULD PROCEED.**

While the ILR bemoans the cost of defending securities fraud actions, it also must acknowledge that legislation like the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 were enacted after the PSLRA to heighten corporate duties and assist private plaintiffs in their ability to obtain relief. These reforms were enacted because fraud continued to be prevalent. Further underscoring the value of private investor enforcement of the securities laws, an empirical study found that private class actions resulted in higher incidences of top officer resignations than SEC investigations. [9]

The ILR's claim that the increase in securities fraud filings reflects the need for a legislative remedy misapprehends correlation for causation. Although the number of filings has increased and the number of financial restatements has declined, it would be inaccurate to say that, therefore, legislative remedies must curtail meritless securities fraud actions. The fact that private securities actions are on the rise is not a reason to legislate against "event-driven" litigation because frequently investors are also injured when a corporation misrepresents the risks associated with its operations. As the ILR's own statistical data regarding dismissal rates shows, courts are more than capable of weeding out the weak cases from the strong and, as historic mega-settlements show, the strong ones should proceed. ■

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## ENDNOTES

[1] U.S. Chamber Institute for Legal Reform: *A Rising Threat: The New Class Action Racket That Harms Investors and the Economy* (October 24, 2018) https://www.instituteforlegalreform.com/research/a-rising-threat-the-new-class-action-racket-that-harms-investors-and-the-economy

[2] U.S. Chamber Institute for Legal Reform: *Containing the Contagion: Proposals to Reform the Broken Securities Class Action System* (February 25, 2019): https://www.instituteforlegalreform.com/research/containing-the-contagion-proposals-to-reform-the-broken-securities-class-action-system

[3] https://www.auditanalytics.com/blog/2016-financial-restatements-review/

[4] The U.S. Chemical Safety Board concluded, "BP had multiple safety management system deficiencies that contributed to the Macondo incident." https://www.csb.gov/csb-investigation-at-the-time-of-2010-gulf-blowout-transocean-bp-industry-associations-and-government-offshore-regulators-had-not-effectively-learned-critical-lessons-from-2005-bp-refinery-explosion-in-implementing-safety-performance-indicators/

[5] The "post-spill" portion of the case alleged that BP misrepresented the amount of oils spilling into the Gulf of Mexico and settled for $175 million, after a summary judgment ruling. Likewise, an Amended Complaint was filed in a securities fraud action against PG&E, which alleges that PG&E misled investors in trying to assuage their concerns about PG&E's liability for the Northern California wildfires when the company claimed it complied with all laws and subsequently received criminal referrals by CalFIRE. PG&E has since announced that the Securities and Exchange Commission is investigating whether it misrepresented its compliance with the securities laws. https://www.nytimes.com/2019/05/02/business/energy-environment/pge-sec-investigation.html [Ivan Penn, *PG&E Says S.E.C. Is Investigating Its Wildfire Disclosures*, New York Times, May 2, 2019]

[6] *See* ISS Securities Class Action Services, https://www.issgovernance.com/securities-class-action-services/ and https://www.issgovernance.com/library/the-top-100-u-s-settlements-of-all-time-as-of-december-2018/

[7] Securities Class Action Services, "The Top 100 U.S. Class Action Settlements of All Time As of December 2018," https://www.issgovernance.com/library/the-top-100-u-s-settlements-of-all-time-as-of-december-2018/

[8] Nessim Mezrahi, *Exposure To Market Fraud Suits Is Not A Major Risk*, Law360, February 21, 2019. https://www.law360.com/securities/articles/1131222%3Cimage004.jpg%3

[9] Stephen J. Choi and Adam Pritchard, *SEC Investigations and Securities Class Actions: An Empirical Comparison*¸ Journal of Empirical Legal Studies, Volume 13, Issue 1, 27–49, March 2016.

# COHEN MILSTEIN LEADS CHARGE AGAINST GOOGLE PARENT ALPHABET AND GENERAL ELECTRIC


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Cohen Milstein is leading shareholder litigation against two iconic U.S. companies whose improper conduct has shaken the confidence of investors and caused significant economic harm.

## *In re Alphabet, Inc. Shareholder Derivative Litigation*

The first case, a derivative lawsuit involving Google parent Alphabet Inc., accuses the company's board of breaching its fiduciary duty by failing to tell investors about market-moving news involving workplace sexual harassment and a massive data breach.

Five months ago, Cohen Milstein filed one of several derivative complaints against certain Alphabet officers and directors on behalf of investors including Northern California Pipe Trades Pension Plan and Teamsters Local 272 Labor Management Pension Fund ("Northern California Plaintiffs' Group"). In May, Santa Clara County Superior Court Judge Brian C. Walsh appointed the Northern California Plaintiffs' Group to serve as lead plaintiff and Cohen Milstein to serve as co-lead counsel in the demand futility cases under the consolidated caption of *In re Alphabet, Inc. Shareholder Derivative Litigation*. In appointing Cohen Milstein, Judge Walsh noted that the firm has "expertise in the legal issues surrounding sexual harassment and employment litigation."

The litigation arises out of a "culture of concealment" fostered by defendants, who allegedly breached their fiduciary duties to Alphabet by participating in or acquiescing in the cover-up of a longstanding pattern of sexual harassment and discrimination by high-powered male executives and their overall failure to respond to or address other forms of sex discrimination and sexual harassment at Alphabet.

> **COHEN MILSTEIN IS LEADING SHAREHOLDER LITIGATION AGAINST TWO ICONIC U.S. COMPANIES WHOSE IMPROPER CONDUCT HAS SHAKEN THE CONFIDENCE OF INVESTORS AND CAUSED SIGNIFICANT ECONOMIC HARM.**

**THE *ALPHABET* LITIGATION ARISES OUT OF A "CULTURE OF CONCEALMENT" FOSTERED BY DEFENDANTS, WHO ALLEGEDLY BREACHED THEIR FIDUCIARY DUTIES TO ALPHABET BY PARTICIPATING IN OR ACQUIESCING IN THE COVER-UP OF A LONGSTANDING PATTERN OF SEXUAL HARASSMENT AND DISCRIMINATION BY HIGH-POWERED MALE EXECUTIVES AT GOOGLE.**

The lawsuit also alleges that defendants failed to disclose a data privacy breach that exposed the personal data of a half a million users of Google+, a social networking website operated by the company, potentially in violation of a consent decree the company entered into with the Federal Trade Commission in 2011.

Cohen Milstein continues its investigation into these matters, which includes reviewing internal Alphabet documents that were produced pursuant to a statutory demand for books and records. On behalf of the Northern California Plaintiffs' Group, the firm will file a consolidated amended complaint later this summer.

## *In re General Electric Securities Litigation*

On June 21, Cohen Milstein, representing its client Teachers' Retirement System of Oklahoma ("TRS"), filed an amended complaint against General Electric ("GE") and certain of its officers for federal securities fraud. The filing came two months after U.S. District Court Judge Denise Cote of the Southern District of New York appointed TRS as Lead Plaintiff and Cohen Milstein as Lead Counsel.

TRS is pursuing the action on behalf of purchasers of GE securities between December 4, 2017 and December 6, 2018 ("Class Period"), who relied on GE's false and misleading statements and omissions regarding two initiatives in GE's power segment that were intended to revive GE's flailing power business: the launch of GE's flagship H-class gas turbine and the November 2015 acquisition of French power company Alstom S.A., for which GE recognized over $17 billion in goodwill. GE's alleged deception about the H-class gas turbine and Alstom acquisition came to light at the end of the Class Period, causing GE's stock price to crash, its credit rating to be cut to just above investment grade, and civil and criminal investigations by the U.S. Department of Justice.

**THE NEWS ABOUT GE'S ALLEGED DECEPTION CAUSED THE COMPANY'S STOCK PRICE TO CRASH, PROMPTED A CUT TO ITS CREDIT RATING, AND SPARKED CIVIL AND CRIMINAL INVESTIGATIONS BY THE U.S. DEPARTMENT OF JUSTICE.**

In the complaint, Cohen Milstein lays out the case that GE defendants purposefully or recklessly failed to inform investors that a systemic oxidation problem plaguing its H-class gas turbine engines since 2015 was causing them to fail at alarming rates and that the $13.5 billion Alstom acquisition had been doomed from the start.

As alleged, despite defendants telling investors that the H-class gas turbine was the "most efficient and technologically advanced" gas turbine in the market because it could operate for 25,000 hours, the H-class gas turbine was unable to hit its performance guarantees due to oxidation that was forming on the blades that caused them to break and damage other component parts. To prevent oxidation-related damage and manage the problem, power plants utilizing the H-class gas turbines would shut down the turbine after only 7,000 hours, drastically reducing power production and continuous operation. By the fall of 2018, field failures were becoming more prevalent and H-class gas turbine sales were cratering, but GE told investors it was due to "soft" market conditions. After months of negative reporting on the H-class gas turbine and reactive stock drops, the complaint alleges, the full extent of the oxidation problem was revealed on December 7, 2018 when *Reuters* published an exclusive report that 18 power plants utilizing GE H-class gas turbines "from Taiwan to France" were shut down for repairs and that GE was setting aside $480 million for repairs of its H-class and 9FB gas turbines.

**THE COMPLAINT LAYS OUT THE CASE THAT THE GE DEFENDANTS PURPOSEFULLY OR RECKLESSLY FAILED TO INFORM INVESTORS THAT A SYSTEMIC OXIDATION PROBLEM PLAGUING ITS H-CLASS GAS TURBINE ENGINES SINCE 2015 WAS CAUSING THEM TO FAIL AT ALARMING RATES AND THAT THE $13.5 BILLION ALSTOM ACQUISITION HAD BEEN DOOMED FROM THE START.**

The catastrophic failure of the H-class gas turbines and an utter lack of predicted "synergies" that the Alstom acquisition was supposed to create revealed that GE had materially inflated goodwill figures for the power segment on its balance sheet in each of its financial statements for the quarters ending on December 31, 2017, March 31, 2018 and June 30, 2018. By October 2018, GE had a change in leadership and Larry Culp, GE's new Chief Executive Officer, quickly took one of the largest impairments of goodwill in corporate history—writing off $22 billion dollars of goodwill and cutting the dividend to a single penny.

As the complaint details, these events and the actions taken by Defendants support the claims that Defendants violated Sections 10(b) and 20(a) of the Exchange Act of 1934. Defendants will seek to dismiss the complaint with a filing due on August 2, 2019. ■

*Christina D. Saler is of counsel to the firm and a member of the Securities Litigation & Investor Protection practice group.*

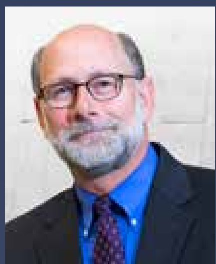
# Three Cohen Milstein Attorneys Recognized as Finalists for Public Justice's 2019 Trial Lawyer of the Year Award

Julie Reiser, Molly Bowen, and Ray Sarola have been named finalists for Public Justice's 2019 Trial Lawyer of the Year Award, in recognition of their work on *Englund v. World Pawn Exchange*. The finalist teams were selected for their outstanding contributions to the public interest through precedent-setting litigation. The team represented the family of Kirsten Englund, the victim of gun violence at the hands of a mentally ill man alleged to have illegally straw-purchased firearms from an online gun dealer, which he used to murder Ms. Englund. The case established first-in-the-nation rulings that online gun dealers can be liable for straw sales, just like their in-store counterparts. The team reached favorable settlements with all defendants that resulted in significant financial relief and, more importantly, meaningful business reforms to help prevent future firearm violence.

Public Justice's mission is to pursues high impact lawsuits to combat social and economic injustice, protect the Earth's sustainability, and challenge predatory corporate conduct and government abuses. Each year, Public Justice recognizes lawyers who fulfill this same mission.

Cohen Milstein is deeply committed to providing high-quality pro bono legal services for underserved communities and victims of grave abuses. The Englund team's selection as one of only five finalists for Trial Lawyer of the Year Award reflects the complexity of the case and the national significance of the results achieved. The team is honored to represent the Englund family in their courageous effort to transform the law and business practices to promote public safety.

**PUBLIC JUSTICE'S MISSION IS TO PURSUES HIGH IMPACT LAWSUITS TO COMBAT SOCIAL AND ECONOMIC INJUSTICE, PROTECT THE EARTH'S SUSTAINABILITY, AND CHALLENGE PREDATORY CORPORATE CONDUCT AND GOVERNMENT ABUSES. EACH YEAR, PUBLIC JUSTICE RECOGNIZES LAWYERS WHO FULFILL THIS SAME MISSION.**



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# FIDUCIARY FOCUS

## RECENT EVENTS UNDERSCORE THE NEED TO FOCUS ON EVOLVING FIDUCIARY DUTY

The last few months have offered several examples of why attention to fiduciary duty remains a critical and evolving component of a pension plan trustee's responsibility. Debates about the precise nature of fiduciary duty, its appropriate application, and its scope have popped up in the retail, the regulatory, and the pension fund spaces. These debates underscore the need for pension fund trustees to remain focused on and current about their fiduciary responsibility.

In April, President Trump signed an executive order promoting energy infrastructure and economic growth that requires the Secretary of Labor to review existing guidance regarding the fiduciary duty for proxy voting. Because they take seriously DOL guidance on ERISA (the law governing private pensions), public pension fund trustees may well be affected by this executive order when making ESG-related assessments in this area.

In June, the SEC adopted Regulation Best Interest (Regulation BI) to impose new rules for brokers when offering investment advice. The precise nature of the fiduciary responsibility required by brokers under Regulation BI was subject to interpretation and not resolved by its over 700 pages. Industry advocates lauded Regulation BI for its protective features while consumer advocates were less sure that fiduciary obligations as promised were as clear as touted. At about the same time, the House of Representatives passed the SECURE Act, which may have muddled the precise nature of the fiduciary obligations of employers who offer annuities in their retirement plans.

Also, a commissioner of the Commodities Futures Trading Commission is creating a panel of experts to explore the impact of climate change on financial markets while state financial regulators and legislators are considering the impacts of some of the recent changes affecting fiduciary duty in the areas described above.

**THESE DEBATES UNDERSCORE THE NEED FOR PENSION FUND TRUSTEES TO REMAIN FOCUSED ON AND CURRENT ABOUT THEIR FIDUCIARY RESPONSIBILITY.**

These recent actions that can impact the fiduciary duty of brokers, employers, trustees and others reflect the continued essential nature of the responsibility of those entrusted with managing public pension funds.

Public pension trustees must act in the best interests of their members and beneficiaries. The fact that others may have different views of how to exercise that responsibility does not diminish the trustees' ongoing duty in putting the beneficiaries' interests first. Should changes in the legal standards for how public pension trustees must act be adopted, the trustees must remain aware to ensure compliance with that new standard. These may not be easy rules for trustees to follow but they are essential to the proper functioning of the public pension system.

*Luke Bierman is of counsel and adviser to the firm's Ethics and Fiduciary Counseling and Securities Litigation & Investor Protection practice groups.*

## RECENT HIGHLIGHTS

### COHENMILSTEIN IN THE NEWS

- "Equifax to Pay up to $700 Million to Settle State and Federal Investigations into 2017 Security Breach," *The Washington Post* – July 22, 2019
- "Loestrin Buyers Win Cert. in Antitrust Battle with Pharmas," *Law360* – July 17, 2019
- "Supreme Court Takes Fiduciary Case for Overfunded DB Plan," *Pensions & Investments* – July 8, 2019
- "MoneyGram Can't Blame $125M Fine on Software: Investors," *Law360* – July 1, 2019
- "Dignity Health to Pay $100M to Settle ERISA Church Plan Suit," *Law360* – June 28, 2019
- "Fiduciary FAQ: New Rules Could Transform Advisors' Businesses," *Financial Planning* – June 24, 2019
- "BlackRock Employees Seek Class Cert. in $100M ERISA Suit," *Law360* – June 4, 2019
- "The Internet Didn't Shrink 6% Real Estate Commissions. But This Lawsuit Might," *CNN Business* – May 15, 2019
- "Walmart Faces New Round of Gender Discrimination Suits Based on 2001 Dukes Complaint," *Corporate Counsel* – May 14, 2019
- "ADR Case Will Test Reach of Investors on Overseas Businesses," *Pensions & Investments* – May 13, 2019
- "14 Lawyers Appointed to Lead Consumer Suits over Marriott's Data Breach," *Law.com* – April 29, 2019
- "Pain Clinic Group Pays $3.8 Million over Medicare Fraud Claims," *Bloomberg Law* – April 25, 2019
- "The Company That Sells Love to America Had a Dark Secret," *The New York Times Magazine* – April 23, 2019
- "Ruling: Residents' EPA Suit in Flint Crisis Can Move Forward," *The Detroit News* – April 19, 2019

### AWARDS & ACCOLADES

- Cohen Milstein's S. Douglas Bunch, Michael B. Eisenkraft, Laura H. Posner, and Sharon K. Robertson named to *Benchmark Litigation*'s "40 & Under Hot List" – July 15, 2019
- Cohen Milstein's Carol V. Gilden named a 2019 "Women in Law Award Winner" by *Lawyer Monthly* – July 1, 2018
- Cohen Milstein's Christine E. Webber receives the Washington Lawyers' Committee for Civil Rights and Urban Affairs' Roderic V.O. Boggs Award – June 26, 2019
- Cohen Milstein team, including Securities Litigation & Investor Protection Co-Chair Julie Goldsmith Reiser, named a Finalist for Public Justice's "Trial Lawyer of the Year Award" – June 7, 2019
- Cohen Milstein's Antitrust, Civil Rights & Employment, Products Liability, and Securities Litigation groups recognized as "Leading Practices" by *The Legal 500: Guide to the US Legal Profession* – May 29, 2019
- Cohen Milstein named an "Elite Trial Lawyer" Finalist in five practice areas, including Securities Litigation, by *The National Law Journal* – May 29, 2019
- Cohen Milstein's Agnieszka Fryszman and Sharon Robertson named "Elite Women of the Plaintiffs Bar" by *The National Law Journal* – May 29, 2019
- Cohen Milstein recognized among "The Best Law Firms for Female Attorneys" in *Law360*'s 2019 Glass Ceiling Report – May 27, 2019
- Twenty-one Cohen Milstein attorneys recognized as 2019 Super Lawyers; nine recognized as 2019 Rising Stars – May 1, 2019
- Cohen Milstein named to *The National Law Journal's* 2019 "Pro Bono Hot List" – April 30, 2019

## UPCOMING EVENTS

- **August 3-7** | National Association of State Retirement Administrators (NASRA) Annual Conference, Williamsburg, VA – Richard Lorant and Julie Reiser
- **August 4-7** | County Commissioners Association of Pennsylvania (CCAP) Annual Conference, Reading, PA – David Maser
- **August 18-20** | Texas Association of Public Employee Retirement (TEXPERS) 2019 Summer Educational Forum, Frisco, TX – John Dominguez
- **September 16-18** | Council of Institutional Investors (CII) Fall 2019 Conference, Minneapolis, MN – Daniel Sommers and Jay Chaudhuri
- **September 18** | Oklahoma State Firefighters Association (OSFA) Fallen and Living Firefighters Memorial Golf Tournament, Lincoln Park Golf Course, Oklahoma City, OK – Richard Lorant
- **September 21-24** | Michigan Association of Public Employee Retirement Systems (MAPERS) 2019 Fall Conference – Richard Lorant and Christina Saler
- **September 23-25** | National Coordinating Committee for Multiemployer Plans (NCCMP), Hollywood, FL – Christopher Lometti and Arthur Coia

# ATTORNEY PROFILE

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> “Working for the SEC was a tremendous experience that taught me how to conduct an investigation and build a solid case. These skills have served me well, especially considering the complexity and heightened pleading standards of federal securities cases.”

**Carol Gilden joined Cohen Milstein in 2007 and is a partner in the Securities Litigation & Investor Protection Practice Group. Carol is the resident partner of the firm's Chicago Office and oversees its activities. She also serves on the firm's Compensation Committee. Carol's leadership has extended beyond Cohen Milstein and the cases that she litigates. She served as the first woman President of the National Association of Shareholder and Consumer Attorneys (NASCAT) and as a member of the Corporate Governance and Markets Advisory Councils to the Council for Institutional Investors' (CII) Board of Directors. Carol has received many professional honors over the years, and most recently was named a 2019 "Women in Law Award Winner" by *Lawyer Monthly*. For this issue of the *Shareholder Advocate*, Carol talked with Editor Christina Saler about why she considers herself a Midwesterner and starting out at the SEC.**

**I grew up in …** the Northwest suburbs of Chicago. My family relocated there from the East Coast after my dad (a chemical engineer) was offered an exciting opportunity at a Fortune 100 company in the city. At the time, I was 14 and ready for a new adventure! And, the move really did start off with an adventure. We had two dogs, and my mother wouldn't think of putting them on a plane for the trip to Chicago. Instead, she and I took our dogs on the long train ride from Philadelphia to Chicago. On the periodic stops, we took the dogs out for brisk walks, with the conductors waving us back on when it was time for the train to take off again. They were the conductors' favorite passengers.

**I knew I wanted to be a lawyer …** in my third year of undergraduate study. I majored in business and was taking various economics, finance and accounting classes at the University of Illinois in Champaign-Urbana. Although I thoroughly enjoyed those classes, the light really went off for me when I took a business law class that was taught by a professor from the University's law school. The analytical intensity of the coursework totally drew me in. I decided to continue my business studies by completing an international business program, which included studies at the London School of Economics, and then apply for law school. I took my Law School Admissions Test (LSAT) in London at a barrister's club that didn't admit women at the time—the irony of it!

**I started practicing law at …** the Securities Exchange Commission (SEC) Enforcement Division right out of law school. Typically, the SEC only hires lawyers with six-to-seven years of practical experience but the year I was graduating from law school, the SEC implemented a program to bring in newly minted lawyers and partner them with experienced investigators. On my first day, I was handed a badge and expected to jump right in! In fact, within months of joining the SEC, my partner-investigator and I made a surprise visit to a broker-dealer selling sham limited partnerships. We flashed our badges and were given full access to the files. Soon afterward we brought an enforcement action to shut down the Ponzi scheme being sold by the broker-dealer. Working for the SEC was a tremendous experience that taught me how to conduct an investigation and build a solid case. These skills have served me well, especially considering the complexity and heightened pleading standards of federal securities cases.

**On my bookshelf are …** mostly non-fiction books. I'm a bit of a history buff. I'm currently reading *Five Days in London* written by John Lukacs which is about the five days (May 24 – 28, 1940) in which Winston Churchill and the War Cabinet debated whether to negotiate with, or essentially concede to, Hitler or press forward with the war. Even though we all know the ending, the retelling of this piece of history is gripping.

**Summertime in Chicago is …** fantastic! I highly recommend walking along the Lakefront and going in and out of the city's wonderful museums and stopping in at Lou Malnati's for, what I consider, the best Chicago deep dish pizza. ■

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