Spring 2024

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Pluralsight Litigation Ends in Significant Settlement and Good Precedent in the Tenth Circuit

After four years of hard-fought litigation, lead plaintiffs in a certified class action against Pluralsight, Inc. and two of its executives have filed for preliminary approval of a $20 million settlement.

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Pluralsight Litigation Ends in Significant Settlement and Good Precedent in the Tenth Circuit

After four years of hard-fought litigation, lead plaintiffs in a certified class action against Pluralsight, Inc. and two of its executives have filed for preliminary approval of a $20 million settlement. Cohen Milstein serves as court-appointed lead counsel in the case, representing lead plaintiffs Indiana Public Retirement System and Public School Teachers' Pension and Retirement Fund of Chicago. The substantial settlement is a significant victory for lead plaintiffs and the class of investors, who overcame an initial order dismissing the case by successfully appealing to the Tenth Circuit, resulting in a landmark opinion on the application of scienter to Rule 10b5-1 trading plans.

In March 2020, the Court appointed lead plaintiffs to lead the case, which was originally filed in August 2019. Filing an amended complaint three months later, lead plaintiffs alleged that defendants misrepresented the size of the company's sales force—the main driver of Pluralsight's quarter-over-quarter billings growth and the key business metric by which Pluralsight attracted investors. The complaint also alleged that the company and its CEO and CFO knew that Pluralsight misrepresented the size of the sales force, intentionally withheld this pertinent information from investors, and reaped millions of dollars in profits by selling stock to unsuspecting investors.

Just over a year later, in August 2021, the U.S. District Court for the District of Utah dismissed the amended complaint, finding, among other things, that Pluralsight's use of predetermined stock trading plans (established in 2000 by the Securities and Exchange Commission in Rule 10b5-1) automatically removed defendants' motive to manipulate the company's stock price. Lead plaintiffs appealed the case to the Tenth Circuit, presenting an emerging issue of first impression.

In the closely watched appeal, an *amici curiae* brief was filed by former SEC Commissioners Robert J. Jackson and Luis A. Aguilar, former SEC Chief Accountant Lynn Turner and Columbia Law Professor Joshua Mitts, along with other prominent academics, who urged reversal, explaining that the "text and history of Rule 10b5-1 shows that such plans can be manipulated easily for personal financial gain and thus cannot rebut the inference that personal financial gain was a motive for defendants' material misrepresentations."

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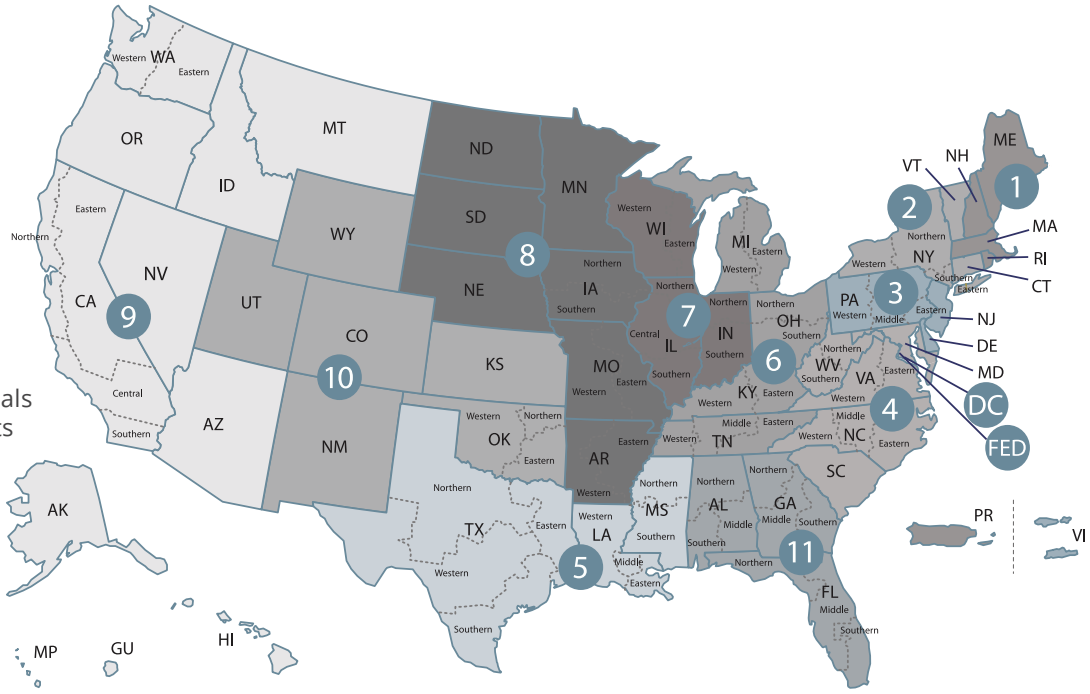
COHEN MILSTEIN SERVES AS COURT-APPOINTED LEAD COUNSEL IN THE CASE, REPRESENTING LEAD PLAINTIFFS INDIANA PUBLIC RETIREMENT SYSTEM AND PUBLIC SCHOOL TEACHERS' PENSION AND RETIREMENT FUND OF CHICAGO.

THE SUBSTANTIAL SETTLEMENT IS A SIGNIFICANT VICTORY FOR LEAD PLAINTIFFS AND THE CLASS OF INVESTORS, WHO OVERCAME AN INITIAL ORDER DISMISSING THE CASE BY SUCCESSFULLY APPEALING TO THE TENTH CIRCUIT, RESULTING IN A LANDMARK OPINION ON THE APPLICATION OF SCIENTER TO RULE 10B5-1 TRADING PLANS.

In its August 23, 2022 opinion reversing the district court's dismissal, the Tenth Circuit held, among other things, that the existence of a 10b5-1 trading plan does "not *per se* rebut an inference of scienter where … a defendant was allegedly motivated to misrepresent or withhold material information to affect a stock price." In its ruling, the Tenth Circuit explained that these plans do not prevent officers from "making false statements to artificially inflate the stock price to trigger those automatic trades—and that is what Plaintiffs allege occurred here."

Apart from its important scienter ruling, the Tenth Circuit also held that lead plaintiffs plausibly alleged that defendants made a false and misleading statement at the start of the class period, when Pluralsight's Chief Financial Officer, James Budge, told investors that the company had "about 250" quota-bearing sales representatives. As the Tenth Circuit recognized, the complaint alleged that defendants later revealed that Pluralsight only had "about 200" quota-bearing sales representatives at the time, which strongly suggested that Budge's statement was "objectively verifiable" and false. The complaint alleged that the truth was revealed six months later, when the Company reported that its billings growth had plummeted, stunning analysts and investors alike, and causing the stock price to plunge by nearly 40 percent.



GEOGRAPHIC BOUNDARIES
of United States Courts of Appeals and United States District Courts

While the Tenth Circuit's decision was a significant and positive ruling for all investors, the ruling also limited the scope of the case to Budge's single statement. Lead plaintiffs faced significant obstacles in their attempt to hold defendants liable for this statement, which was both false and misleading by omission. But after the Tenth Circuit's reversal, lead plaintiffs continued to vigorously litigate the action, successfully moving for class certification, a motion the district court granted in late December 2023.

In early February 2024, the District Court granted lead plaintiffs' motion to compel regarding the discovery period for the case, a critical ruling that significantly expanded the scope of discovery. About a month later, lead plaintiffs and defendants reached a settlement.

This case demonstrates the importance of institutional investors leading litigation, pressing forward on appeal, and having the ability to marshal support from leading experts on the stock market and federal securities laws, who submitted an *amici* brief to the Tenth Circuit. Lead plaintiffs' advocacy resulted in helpful law and a significant recovery for the class. ■

Carol V. Gilden is a Partner and Jan E. Messerschmidt is an Associate in the firm's Securities Litigation & Investor Protection practice group.

IN ITS AUGUST 23, 2022 OPINION REVERSING THE DISTRICT COURT'S DISMISSAL, THE TENTH CIRCUIT HELD, AMONG OTHER THINGS, THAT THE EXISTENCE OF A 10B5-1 TRADING PLAN DOES "NOT *PER SE* REBUT AN INFERENCE OF SCIENTER WHERE … A DEFENDANT WAS ALLEGEDLY MOTIVATED TO MISREPRESENT OR WITHHOLD MATERIAL INFORMATION TO AFFECT A STOCK PRICE."

LAWSUIT SEEKS TO HOLD ABBOTT LABORATORIES DIRECTORS ACCOUNTABLE FOR BABY FORMULA CONTAMINATION

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In winter 2022, families were devastated by a nationwide infant formula shortage. The shortage stemmed from a recall and the sudden shutdown of one of Abbott Laboratories' infant formula factories after concerns developed about contaminated infant formula. Cohen Milstein is co-lead counsel in a shareholder derivative lawsuit seeking to hold Abbott's board of directors and certain members of executive leadership responsible for breaches of fiduciary duty (and other claims) arising from that debacle.

What is a Shareholder Derivative Lawsuit?

Directors and officers of public companies owe fiduciary duties, including the duties of care, loyalty, oversight, and candor. When a director or officer breaches those duties in a way that harms the company, shareholders are empowered to bring a claim to hold that director or officer accountable and to remedy the harm. The ways a director or officer can breach their fiduciary duties include allowing the company to engage in illegal activity, failing to set up systems for the board to properly oversee the company's business and make informed decisions on its behalf, and self-dealing.

Under the laws of most states, including Delaware, where many companies are incorporated, shareholders looking to investigate a possible claim may ask to inspect a company's books and records as a first step. (For more on books and records demands, see our Securities Litigation 101 article on page 11.) If after review of those books and records or other publicly available information the shareholder concludes that misconduct may have occurred, the shareholder has certain options. One option is for the shareholder to make a demand on the board to bring those claims on the company's behalf against those who engaged in the misconduct. However, the "demand" requirement may be excused in certain cases if a majority of the board lacks independence or faces a substantial likelihood of liability. Under those circumstances, the shareholder can argue that

making a demand would be futile and therefore that requirement should be excused by the court. The shareholder plaintiff would then "step into the shoes" of the company and pursue a claim on its behalf—essentially, protecting the company from the directors and officers who failed to protect it. Unlike a class action where the plaintiff is suing the company and hoping to recover money for injured class members, a shareholder derivative lawsuit seeks relief on behalf of the company. A successful resolution may include a financial recovery for the company and/or corporate governance reforms to reduce the likelihood that the misconduct reoccurs.

THE SHORTAGE STEMMED FROM A RECALL AND THE SUDDEN SHUTDOWN OF ONE OF ABBOTT LABORATORIES' INFANT FORMULA FACTORIES AFTER CONCERNS DEVELOPED ABOUT CONTAMINATED INFANT FORMULA.

The Abbott Lawsuit

On October 16, 2023, the International Brotherhood of Teamsters Local No. 710 Pension Fund and Southeastern Pennsylvania Transportation Authority were appointed as lead plaintiffs in *In re Abbott Derivative Litigation*, pending in the Northern District of Illinois. Cohen Milstein represents the lead plaintiffs, along with co-counsel.

Abbott is one of the primary manufacturers of infant formula in the U.S. and is the leading provider of infant formula to low-income families through federal government programs. Abbott's plant in Sturgis, Michigan is a key producer of formula.

Plaintiffs allege that Abbott's leadership wholly failed to implement reasonable systems to oversee infant formula manufacturing and production—a striking oversight given the potentially severe consequences of unsafe infant formula—and ignored red flags of safety and compliance problems that arose. As a result, safety and compliance issues persisted at the Sturgis plant for years, as reported by whistleblowers and FDA inspections that found violations of regulations and resulted in Abbott receiving multiple notices of "significant objectionable conditions." Moreover, Abbott's own records reflected that it had detected Cronobacter, a potentially harmful bacteria, in products or the facility as early as 2019; the company had also received complaints about babies who became sick after consuming Abbott formula.

These worrisome conditions culminated in winter 2021. After a second complaint of a bacterial infection in an infant who was fed Abbott formula and later died, the FDA demanded that Abbott allow it to conduct a "for-cause" inspection. The FDA found multiple compliance failures associated with bacterial breeding and contamination risks, and detected Cronobacter at the Sturgis plant. After multiple requests from the FDA, on February 15, 2022, Abbott finally closed the Sturgis plant and two days later announced a "voluntary" infant formula recall.

The multi-month closure of the factory and the recall triggered a nationwide shortage of baby formula. Abbott ultimately entered into a Consent Order

with the Department of Justice to resolve an inquiry into these concerns. Additionally, Abbott's business suffered hundreds of millions in lost sales and profits, as well as costs to remediate the facility and upgrade compliance, risk management, and internal control systems. The business also suffered reputational harm as a result of the regulatory, criminal, and Congressional scrutiny. Abbott currently faces numerous lawsuits, including wrongful death, personal injury, and whistleblower actions, as well as consumer and investor class actions.

Plaintiffs allege that Abbott's leadership breached their fiduciary duties by failing to implement adequate reporting mechanisms and information oversight systems to oversee the mission-critical issue of infant formula safety and compliance and failed to respond to red flags of safety issues and non-compliance. The lawsuit also alleges that certain directors caused Abbott to make false and misleading statements to the investing public about these highly material issues. As a result, plaintiffs say Abbott's leadership failed to take action to ensure the safe production of infant formula and thereby prevent infant sicknesses and deaths linked to Abbott's formula, as well as the harm to the business discussed above.

Defendants have moved to dismiss the lawsuit, and that motion has been fully briefed. A decision will be forthcoming from the court.

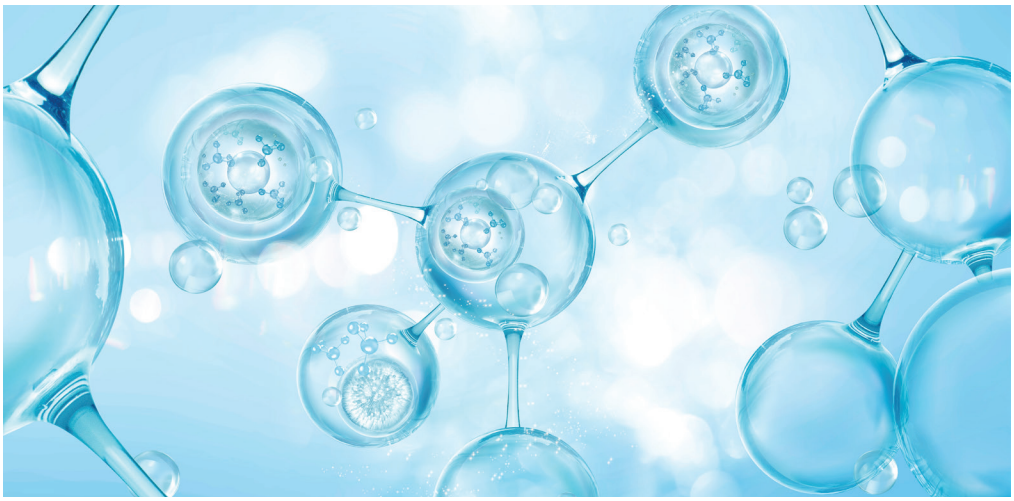
Conclusion

The *Abbott* lawsuit reflects the important role of investors in holding corporate leaders accountable when they breach their fiduciary duties, particularly when critical health and safety issues are involved. It is also an example of the important role of courts outside Delaware in investor protection and public company oversight. While Delaware is the national center of corporate law since most publicly traded companies are currently incorporated there, Cohen Milstein considers all potential venues when evaluating a new case. As a result, we have achieved significant success in derivative litigation in state and federal courts across the country, including California, Ohio, and Illinois. We look forward to continuing to partner with our clients in these important lawsuits. ■

Carol V. Gilden and Molly J. Bowen are Partners in the firm's Securities Litigation & Investor Protection practice group.

PLAINTIFFS ALLEGE THAT ABBOTT'S LEADERSHIP WHOLLY FAILED TO IMPLEMENT REASONABLE SYSTEMS TO OVERSEE INFANT FORMULA MANUFACTURING AND PRODUCTION—A STRIKING OVERSIGHT GIVEN THE POTENTIALLY SEVERE CONSEQUENCES OF UNSAFE INFANT FORMULA—AND IGNORED RED FLAGS OF SAFETY AND COMPLIANCE PROBLEMS THAT AROSE.

BIOLOGICS ANTITRUST LITIGATION: AN IMPORTANT TOOL FOR EMPLOYERS TO RECOVER PRESCRIPTION DRUG OVERCHARGES



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ANTITRUST LITIGATION CONTINUES TO BE AN IMPORTANT VEHICLE FOR EMPLOYERS, MULTI-EMPLOYER HEALTH FUNDS, AND PUBLIC ENTITIES TO RECOVER DAMAGES FOR INFLATED PRICES THEY HAVE PAID FOR PRESCRIPTION DRUGS THROUGH THEIR EMPLOYEE BENEFITS PACKAGE.

Antitrust litigation continues to be an important vehicle for employers, multi-employer health funds, and public entities to recover damages for inflated prices they have paid for prescription drugs through their employee benefits package. Cohen Milstein has been at the forefront of these cases, serving as lead counsel and recovering hundreds of millions of dollars for employers who overpaid for prescription drugs. This article takes a forward-looking view of likely future developments in this area—specifically regarding the industry's shift towards "biologic" drugs. Remaining well-advised about this area of the law will benefit employers and Taft-Hartley healthcare funds covering union workers, by enabling them to decide when they may want to participate in this type of litigation to recover the overcharges they have incurred on employees' prescription drug purchases.

Generic Delay Cases and Biosimilars: Overview

Generic-delay antitrust litigation involves claims that pharmaceutical companies have improperly delayed the market entry of lower-priced generic versions of a drug, thereby causing payers (e.g., self-insured employers) to overpay for a period of time. Perhaps the most well-known type of generic-delay case is the "reverse-payment" or "pay-for-delay" case, which was recognized by the Supreme Court in *FTC v. Actavis*. In these cases, a company with a patent-protected drug whose patent is expiring pays generic manufacturers not to produce the drug.

Generic-delay cases have traditionally focused on small-molecule drugs—which are governed by the 1984 Hatch-Waxman Act. But an increasingly large share of prescription drug payments now goes towards biologics. Biologics are derived from living cells, and their therapeutic equivalents are called biosimilars. The statute authorizing biosimilars was enacted in 2010. Despite their relative nascency, biologics and biosimilars now account for approximately 46% of U.S. prescription drug spend—$261 billion per year.

WITH SUCH SUBSTANTIAL REVENUES AT STAKE, PHARMACEUTICAL COMPANIES HAVE STRONG MOTIVATIONS TO USE ANTICOMPETITIVE TACTICS TO DELAY THE ONSET OF BIOSIMILAR COMPETITION, JUST AS THEY HAVE TO DELAY THE ENTRY OF SMALL-MOLECULE COMPETITION.

With such substantial revenues at stake, pharmaceutical companies have strong motivations to use anticompetitive tactics to delay the onset of biosimilar competition, just as they have to delay the entry of small-molecule competition. Differences between small-molecule generic markets and biosimilar markets, however, may warrant special attention as the same litigation strategies that have successfully policed small-molecule delay cases may require adjustment in biosimilar cases.

Those differences were well illustrated by 2023's launch of biosimilar versions of Humira. Humira was the single-largest line item in the 2022 U.S. pharmaceutical budget. Americans spent over $18 billion on the biologic, over which the manufacturer had long maintained a monopoly. In mid-2023, however, a wave of biosimilar Humira competitors finally came to market and are helping to lower prices.

Same-Tier Formulary Coverage

Payers (and pharmacy benefit managers acting on their behalf) use several tools to incentivize the use of lower-priced generic drugs. One tool is the "formulary," a list that organizes drugs into "tiers" which render drugs more or less expensive for a plan member. For example, a formulary may impose a $10/$30/$50 copay for drugs on the first/second/third tiers, with generic drugs usually on the least-expensive first tier.

Despite biosimilar versions of Humira carrying a lower list price than the brand product, many biosimilars are nonetheless being placed on formulary tiers equal to those of the brand. This means that biosimilars may not capture the same high level of market shares as do small-molecule generics, as patients will not be incentivized to use the biosimilar by the promise of lower copays.

If biologics maintain greater share following biosimilar entry, one consequence in biosimilar-delay cases will be an increased importance of "brand-brand damages." As with small-molecule drugs, biosimilar competition can drive down the price of the brand drug compared to what the brand's price would be without competition. Thus, even where payers would have purchased the brand drug rather than the biosimilar, they should have paid less for the brand and were damaged. These are called "brand-brand damages." For payers who may pursue biosimilar-delay litigation, they should be sure to seek brand-brand damages when available.

One Biosimilar, Two Prices

Another dynamic that has appeared in biosimilar markets is companies launching the same product at two different price points: one with a high list price and substantial rebates, and a second with a lower list-price but few or no rebates. Biosimilar versions of Humira have generally coalesced around 5% off and 85% off Humira's list price, with multiple companies offering both a high-list price and low list-price version.

This dynamic will affect damages calculations in biosimilar-delay cases. In small-molecule cases, experts generally identify what the "brand" price is and what the "generic" price would have been at a given time. Identifying a "generic" price is possible because small-molecule markets tend to coalesce closely around a prevailing price. Unlike in small-molecule cases, however, the launch of biosimilar Humira products shows that there will be biosimilars marketed with markedly different list prices.

Payer-Plaintiffs might address this dynamic in different ways. One could be to group together the brand with the high-priced biosimilars as being the "brand" price and consider the lower-priced drugs as representing the "biosimilar" price. Another approach could be to model the market as having three price-points: a brand price, a high-priced biosimilar, and a low-priced biosimilar. Whatever strategy is ultimately taken, experts can help to understand the different biosimilar prices and address this dynamic in plaintiffs' damages models.

Product-Specific Differences

Unlike with small-molecule generic drugs, there may be product-specific differences among the biosimilars. For example, some (but not all) Humira biosimilars contain citrate—an ingredient that can cause pain at the injection site. Some (but not all) Humira biosimilars are marketed in a high-concentration formula. In litigation, drug manufacturer defendants may attempt to seize on such product-specific differences to resist efforts to hold them accountable for anticompetitive conduct. For example, defendants could seek to argue that these differences affect class certification or the relevant product market definition. In turn, payer-plaintiffs should be prepared to retain experts to prepare for and respond to these arguments.

Conclusion

The emergence of biosimilars is a beneficial development for the payers, as these affordable medicines stand to save Americans approximately $180 billion over the next five years. Thus, cases policing anticompetitive delay of biosimilar competition will remain an important tool for antitrust enforcers to promote competition in healthcare markets—and for employers and multi-employer health funds to ensure that their employees and members are able to recover the inflated prices they have paid for prescription drugs.

Editor's Note – A more in-depth version of this article, along with footnoted sources, is available on *Law360*. ■

AS WITH SMALL-MOLECULE DRUGS, BIOSIMILAR COMPETITION CAN DRIVE DOWN THE PRICE OF THE BRAND DRUG COMPARED TO WHAT THE BRAND'S PRICE WOULD BE WITHOUT COMPETITION.

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SECURITIES LITIGATION 101:

BOOKS AND RECORDS DEMANDS OFFER SHAREHOLDERS A POWERFUL TOOL

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In our inaugural installment of Securities Litigation 101, we discussed the ins and outs of shareholder derivative actions—lawsuits in which shareholders act on behalf the company to sue its directors for fiduciary breaches that caused harm to the company. Today, we will explore a powerful tool that shareholders can use to determine whether to file a derivative lawsuit: a books and records demand.

These procedures, often referred to as Section 220 demands for the section of the Delaware General Corporation Law (DGCL) that gives shareholders the right to inspect records of Delaware corporations, are also available outside the First State. By seeking internal board materials, shareholders can determine whether a company's board of directors acted properly from a fiduciary standpoint or, conversely, can lay the groundwork for potential derivative litigation.

Submitting a books and records demand is straightforward and follows relatively the same process under each state's corporate laws. If the shareholder has a "proper purpose"—defined as one "reasonably related to such person's interest as a stockholder"—counsel prepares a letter explaining the concerns and basis for the document requests. A proper purpose for making a demand may include valuing the shareholder's interest in the corporation or investigating possible wrongdoing, such as breaches of fiduciary duty by directors or officers that could include corporate waste, self-dealing, failure to oversee the business, allowing the business to engage in illegal activity, or insider trading. Along with the letter, the shareholder provides proof of their ownership of the stock during the relevant period and a power of attorney authorizing counsel to make the demand on their behalf.

BY SEEKING INTERNAL BOARD MATERIALS, SHAREHOLDERS CAN DETERMINE WHETHER A COMPANY'S BOARD OF DIRECTORS ACTED PROPERLY FROM A FIDUCIARY STANDPOINT OR, CONVERSELY, CAN LAY THE GROUNDWORK FOR POTENTIAL DERIVATIVE LITIGATION.

Once a shareholder clears these hurdles, they are typically able to obtain access to board documents (such as board meeting agendas, minutes, and presentations), policies and procedures, and annual directors' and officers' questionnaires. The scope of the board materials to be produced is defined by the evolving caselaw in the particular state where the company is incorporated.

Annual directors' and officers' questionnaires are particularly helpful in identifying any intertwined relationships between the executives running the company and the directors charged with its oversight. Certain interdependencies may mean board members lack

independence, thus making it "futile" to demand that the board bring claims against the company in a derivative action and allowing the shareholder to sue the board on the company's behalf to protect the company from further harm—and in turn, protect the shareholder's interest in the company. Derivative litigation does not return money directly to shareholders but rather may seek a monetary remedy for the company itself and/or seek to force companies to address inadequacies in corporate governance oversight, workplace policies, or other shortcomings that can harm shareholder value over the long term.

If the corporation does not comply with the books and records demand, the shareholder may enforce their right to make the demand by filing an action asking the court to compel the company to comply with the demand. These cases, typically summary proceedings, are litigated at an unusually fast pace, with litigators asking for a bench trial as soon as two to three months after filing a complaint. More like an evidentiary hearing than a full-blown trial, books-and-records trials normally last one day or less, with no opening or closing statements.

Cohen Milstein has significant experience issuing books and records demands on behalf of its institutional investor clients to uncover evidence of wrongdoing or mismanagement that would otherwise go unseen. By taking this preliminary step, shareholders can better assess how best to act as responsible stewards of the companies they own before bringing litigation. ■

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BY TAKING THE PRELIMINARY STEP OF MAKING A BOOKS-AND-RECORDS DEMAND, SHAREHOLDERS CAN BETTER ASSESS HOW BEST TO ACT AS RESPONSIBLE STEWARDS OF THE COMPANIES THEY OWN BEFORE BRINGING LITIGATION.

SUPREME COURT PUBLISHES NARROW RULING IN *MACQUARIE*

On April 12, 2024, the Supreme Court issued a unanimous opinion in *Macquarie Infrastructure Corp. et al. v. Moab Partners, L.P., et al.*, 601 U.S. __, (2024), vacating the Second Circuit's ruling and remanding the case for further proceedings consistent with Court's opinion. Writing for the Court, Justice Sotomayor stated that the Court granted certiorari to resolve the "disagreement" among the Circuit Courts of Appeal as to whether a failure to make a disclosure required by Item 303 alone can support a private claim under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5(b) in the absence of an otherwise-misleading statement or "half-truth." The Court answered this question in the negative, holding in a very narrow ruling that: "the failure to disclose information required by Item 303 can support a Rule 10b-5(b) claim only if the omission renders affirmative statements made misleading."

The Court explained that Rule 10b-5(b) does not prohibit pure omissions, but rather requires disclosure of information that will ensure that *an existing statement* is "clear and complete" so as not to mislead investors. Thus, the Rule is applicable to half-truths as they are existing statements but not omissions. Notably, in its opinion however, the Court specifically held that there is a private right of action for half-truths and misstatements under Item 303, and that the Court's holding had no bearing on scheme liability claims under 10b-5(a) and (c) in which no statements or omissions are necessarily pled. Because multiple Circuit Courts had previously held that claims brought under Item 303 were not actionable, the Supreme Court's Opinion means that private litigants can now bring claims for half-truths or misstatements under Item 303 in any court throughout the country. The Supreme Court also declined Defendants' and their amici's requests that it determine where the "line" was in a half-truth sufficient to plead a claim under Item 303, or to hold that certifications made pursuant to Item 303 are not actionable.

Because the plaintiff in *Macquarie* pled actionable misstatements and half-truths under Item 303, we anticipate the case will move forward on those claims upon remand. ■

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FIDUCIARY FOCUS

ENACTED IN 2010, THE SEC'S PAY-TO-PLAY RULE LIMITS INVESTMENT ADVISORS FROM MAKING POLITICAL CONTRIBUTIONS TO CERTAIN STATE AND LOCAL GOVERNMENT OFFICIALS AND CANDIDATES WHO POSSESS THE AUTHORITY TO INFLUENCE THE SELECTION OF AN INVESTMENT MANAGER FOR PUBLIC PENSION FUNDS.

WITH ELECTION SEASON UPON US, ETHICS COUNSEL SHOULD REMAIN VIGILANT ABOUT THE SEC'S PAY-TO-PLAY RULES

With the 2024 general election only eight months away, now is a good time for ethics and compliance counsel of public pension funds to refresh their understanding of the Securities and Exchange Commission's ("SEC") Rule 206-4(5) under the Investment Advisers Act of 1940. It's also a good time to remain vigilant about this so-called "Pay-to-Play Rule" and its implications.

Enacted in 2010, the SEC's Pay-to-Play Rule limits investment advisors from making political contributions to certain state and local government officials and candidates who possess the authority to influence the selection of an investment manager for public pension funds. It should be noted that the Pay-to-Play Rule does not extend to federal officials and candidates. There is an exception to this rule when a certain state or local official is running for federal office. For example, if the Governor of California decides to run for the President of the United States, they would be limited from receiving political contributions from investment advisors because the governor has appointment authority over the California Public Employees' Retirement System. In fact, this scenario played out in the 2012 presidential election. According to *Washington Post* columnist Dan Balz, Republican presidential nominee Mitt Romney eliminated Governor Chris Christie of New Jersey from his vice-presidential short list because Governor Christie would be prohibited from raising money from financial institutions under the Pay-to-Play Rule (Romney also asked Christie to resign as governor, but he refused to do so).

The Pay-to-Play Rule does not extend to every investment advisor. Specifically, the rule applies to political contributions by "covered associates," who may be defined in two ways: (1) general partners, managing members, or executive officers of an investment advisor; and (2) employees who solicit a government entity such as a public pension fund for the advisor, directly or indirectly. The application of the rule may be tricky because it requires determining what investment advisor directly or indirectly supervises a covered associate. On its face, independent contractors may appear outside of the rule; however, an investment advisor may also indirectly supervise them, thus falling under the rule.

The Pay-to-Play Rule also puts in place a two-year "cooling off" period during which an advisor is prohibited from receiving compensation from a public pension fund for two years after an advisor or "covered associate" makes a political contribution. Again, there is an exception: the rule allows an advisor or "covered associate" to make de minimis contributions: (1) $350 per election cycle for candidates running for offices that the advisor can vote for; and (2) $150 for other candidates.

THE APPLICATION OF THE RULE MAY BE TRICKY BECAUSE IT REQUIRES DETERMINING WHAT INVESTMENT ADVISOR DIRECTLY OR INDIRECTLY SUPERVISES A COVERED ASSOCIATE.

Here again, the rule can be tricky to apply because the rule extends to an individual who is not a covered associate at the time of the contribution but then becomes a covered associate during the two-year time period. For example, in 2022, the SEC fined the Asset Management Group of Bank of Hawaii where a similar set of facts occurred. According to the SEC's administrative proceedings, in July 2018, an officer of the Bank of Hawaii, as a noncovered associate, made a $1,000 contribution to the then-governor of Hawaii. Three months later, the officer became an indirect supervisor of the bank's Asset Group, which provided investment advisory services. This change in role converted the officer from a non-covered associate to a covered associate. The SEC determined that the Asset Group of Bank of Hawaii violated the Pay-to-Play Rule because the now covered associate or former bank officer made a political contribution to the governor of Hawaii during the "cooling off" period. The governor of Hawaii possesses the authority to influence the investment advisory services for the University of Hawaii, a client of the investment manager. As a result, the SEC prohibited the investment management firm from receiving advisory fees from the University of Hawaii.

ETHICS AND COMPLIANCE COUNSEL OF PUBLIC PENSION FUNDS SHOULD TAKE THREE STEPS GOING INTO THE ELECTION SEASON.

Therefore, ethics and compliance counsel of public pension funds should take three steps going into the election season. First, ethics counsel should proactively communicate with investment managers about the Pay-to-Play Rule, encouraging such managers to identify "covered associates," adopt preclearance policies, and carry out period compliance checks about campaign contributions to certain state and local officials. Second, ethics counsel should identify a list of local and state elected officials or candidates that possess authority to appoint or influence their pension fund. Finally, ethics counsel should consider reviewing and updating placement agent forms, including disclosures of political contributions under the Pay-to-Play Rule. A "placement agent" may be defined as an internal or external employee to an investment advisor that does marketing on behalf of the investment manager. In some instances, this may not apply since certain states and pension funds have banned the use of placement agents. Taking these proactive steps will provide public pension funds with assurances that there are no compliance concerns. ■

Jay Chaudhuri is Of Counsel in Cohen Milstein's Securities Litigation & Investor Protection practice.

COHENMILSTEIN IN THE NEWS

- "Nikola Investors' SPAC Fraud Suit Moves Ahead," *Law360* – April 10
- "7th Circ. Allows Casino Workers to Appeal Class Cert. Denial," *Law360* – April 9
- "Cohen Milstein Hires CFTC Whistleblower Office Leader In DC," *Law360* – April 2
- "Sweeping Class Certified in Nationwide Pension Plan Suit," *Law360* – March 29
- "Realtors Reach Settlement That Will Change How Americans Buy and Sell Homes," *The Wall Street Journal* – March 15
- "Tyson, JBS to Pay $127 Million to Resolve Workers' Wage-Fixing Lawsuit," Reuters – March 11
- "Transcript: Inside the Traders' Black Box," *UnHedged* – March 7
- "Matterport Stockholders Say Officials Wrongly Cashed $225M," *Law360* – February 28
- "As DOJ Case v. Apple Approaches, Did Apple Shoot Itself in the Foot with Conduct Following Epic Games Ruling?" *The Capitol Forum* – February 27
- "New York Life To Pay $19M To Settle Retirement Plan Suit," *Law360* – February 26
- "Largest Securities-Related Class Action Settlements of 2023," *ISS Securities Class Action Services* – February 15
- "Energizer, Walmart Can't Ditch Battery Pricing Collusion Suits," *Law360* – February 13
- "Flint Residents Reach $25M Settlement with Engineering Firm in Water Crisis Lawsuit," *Detroit Free Press* – February 1
- "JetBlue Says It May Back Out of Deal to Acquire Spirit Airlines," *The New York Times* – January 30
- "New York Life Strikes Deal to End Workers' 401(k) Suit," *Law360* – January 23
- "UFC Loses Bid to End Wage Suppression Case Ahead of Trial," *Law360* – January 19
- "As Cohen Milstein Grows, Law Firm Names New Managing Partner," *The National Law Journal* – January 3

AWARDS & ACCOLADES

- Five Cohen Milstein Attorneys Named to 500 Global Plaintiffs Lawyers for 2024 – *Lawdragon*, April 9
- Carol V. Gilden Recognized Among the Top 25 Attorneys of Illinois for 2024 – *Attorney Intel*, April 9
- Cohen Milstein's Securities Group Named Practice Group of the Year – *Law360*, February 27
- Eight Cohen Milstein Lawyers Named to 500 Leading Plaintiff Consumer Lawyers List – *Lawdragon*, February 23
- Cohen Milstein Lawyers Recognized Among the 500 Leading Lawyers in America – *Lawdragon*, January 17
- Daniel A. Small Named to Lawdragon Hall of Fame – *Lawdragon*, January 16

UPCOMING EVENTS

- **April 21-24** | North America's Building Trades Unions Legislative Conference, Washington, DC – Arthur Coia and Christopher Lometti
- **May 7-10** | State Association of County Retirement Systems Spring Conference, Santa Barbara, CA – Julie Reiser and Richard Lorant
- **May 18-21** | Michigan Association of Public Employee Retirement System 2024 Spring Conference, Mount Pleasant, MI – Richard Lorant
- **May 19-22** | National Conference on Public Employee Retirement Systems Annual Conference & Exhibition, Seattle, WA –Richard Lorant, and J.D. Davis
- **June 1-5** | Massachusetts Association of Contributory Retirement Systems Spring Conference, Hyannis, MA – Richard Lorant
- **June 12** | Oklahoma State Firefighters Association Annual Convention, Midwest City, OK – Richard Lorant
- **June 25-28** | National Association of Public Pension Attorneys Legal Education Conference, Ft. Lauderdale, FL – Carol Gilden, Julie Reiser, Suzanne Dugan, and Luke Bierman

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Jaclyn Weiner is an investigator in the Securities Litigation & Investor Protection Group of Cohen Milstein. Jackie joined the firm in 2018 after working as an investigator for the Department of Justice in Washington, DC. Jackie works closely with Securities Group attorneys to understand the legal theories behind securities fraud and breach of fiduciary duty cases before conducting extensive research to uncover facts from witnesses that support the underlying allegations. For this issue of the **Shareholder Advocate***, Jackie spoke with Editor Christina Saler.*

I grew up in … Gaithersburg and then Potomac, Maryland. I now live with my husband and two children (ages two and four) just ten minutes from my parents. In fact, I have spent most of my life in the Washington, DC area, except for a brief time when I moved across the country to California between undergraduate studies at George Washington University and graduate studies at American University.

I studied … political science and journalism in college and then earned a master's in justice, law, and society. While originally in graduate school for a master's in public administration, I was offered a graduate research position to work on an empirical study that was investigating the factors involved in predicting erroneous convictions. The role required me to interview judges, detectives, law enforcement, and others involved in wrongful convictions or near misses. I found this type of investigative work so interesting and rewarding that I switched my graduate degree to criminal justice and criminology. Following my graduate program, I had a three-year term as a contract investigator with the Maryland Public Defender's office and DC's CJA. I then joined the Department of Justice, where I traveled on investigative assignments all over the country. Working at the DOJ definitely honed my investigative skills, but the constant traveling was wearing, so when I saw the opportunity to join Cohen Milstein in my home city of Washington DC, I jumped at it.

The best part of my job … is when I am able to connect with a witness so that they feel comfortable talking with me and sharing what they observed while working with or in relation to the company I'm investigating. When that connection is formed, the witness is more likely to want to be helpful and share information about the conduct they witnessed. They open up out of their own sense of moral obligation to do the right thing, and I so appreciate their integrity and desire to help.

After the kids go to bed I like to watch … psychological thrillers and really mindless reality TV! My husband and I just rewatched Apple TV's *Severance*, which is such an intriguing show about a team of office workers whose memories are surgically divided between work and personal life. I'm eagerly awaiting the second season, which is currently in the works. ■

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