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# BUSINESS LITIGATION

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*COVID-19-related securities claims and outcomes brought under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) will be shaped by recent court rulings. In this article, we touch upon the "maker" vs. "disseminator" distinction that was the subject of last year's Supreme Court opinion in Lorenzo v. SEC; we discuss a company's duty to update public information addressed in the Ninth Circuit case of Hagan v. Khoja; and we examine the "loss causation" requirement that has proven to be one of the most challenging hurdles plaintiffs must clear when pursuing losses experienced during a global financial crisis.*

# Potential Investment Litigation and Arbitration Trends Arising out of the Coronavirus Financial Crisis: The Effect of Some Recent Legal Holdings

## ABOUT THE AUTHORS


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## ABOUT THE COMMITTEE

The Business Litigation Committee consists of members involved in business and commercial litigation including business torts, contract and other commercial disputes, e-commerce, antitrust issues, trade secrets and intellectual property, unfair competition and business defamation and disparagement. The Business Litigation Committee helps connect members involved in these areas around the world through networking and referral opportunities; developing and keeping current in the substantive, strategic and procedural aspects of business litigation; and affords members an international forum for sharing current developments and strategies with colleagues. Among the committee's planned activities are newsletters, publications, sponsorship of internal CLEs, and Webinars. Learn more about the Committee at www.iadclaw.org.


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The 2000 "Technology Crash" and the 2008 "Mortgage Crisis" precipitated dramatic increases in securities fraud litigation and arbitration that continued for several years after each event. Even though the Mortgage Crisis occurred more than a decade ago, 2019 continued to see significant securities litigation activity. Despite three years of robust overall market growth, plaintiffs regularly file securities lawsuits and repeatedly secure victories on substantial issues of law. Based on this history, and the parallels between those events and the economic downturn resulting from the 2020 COVID-19 pandemic, we believe the United States is likely to see a similar spike in securities litigation and arbitration filings that will last for several years.

COVID-19-related securities claims and outcomes brought under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) will be shaped by recent court rulings. In this article, we touch upon the "maker" vs. "disseminator" distinction that was the subject of last year's Supreme Court opinion in *Lorenzo v. SEC*; we discuss a company's duty to update public information addressed in the Ninth Circuit case of *Hagan v. Khoja*[1]; and we examine the "loss causation" requirement that has proven to be one of the most challenging hurdles plaintiffs must clear when pursuing losses experienced during a global financial crisis.

**"Maker" versus "Disseminator" of Fraudulent Statements - *Lorenzo v. SEC***

The Supreme Court's landmark decision in *Lorenzo v. SEC* (Mar. 2019) expanded liability under Section 10(b) of the Exchange Act and Rule 10b-5 from the original *maker* of a fraudulent misstatement to one who knowingly or recklessly *disseminates* the misstatement. Until the holding in *Lorenzo*, liability under Rule 10b-5 extended only to the "maker" of a statement, i.e., "the person or entity with ultimate authority over the statement." *See Janus Capital Group, Inc. v. First Derivative Traders* (2011).

In *Lorenzo*, a director of investment banking at a brokerage firm was charged with liability under Rule 10b-5 for sending two false and misleading emails to potential investors. Based on the Court's prior holding in *Janus*, the director argued that, because he had merely copied and pasted the false and misleading statements from an email his supervisor sent him, he was not liable under 10b-5 because he was not the "maker" of the statements.

The Supreme Court disagreed, ruling the dissemination of false or misleading statements with the intent to defraud violates Rule 10b-5, even if the disseminator did not "make" the statements. *Lorenzo* involved a defendant with higher authority (a director) and more direct knowledge and control over the content of the statements

[1] Hagan v. Khoja, 139 S.Ct. 2615 (2019).

and their dissemination than the defendant in *Janus*. Moreover, the director-defendant in *Lorenzo* did not challenge findings that he knew the emails contained material misstatements and had sent them with the "intent to deceive, manipulate or defraud" investors. In other words, the conduct in *Lorenzo* is exactly the type of intentional and fraudulent conduct Congress seeks to prohibit in the Exchange Act.

Going forward, where will federal district courts draw the line for actors "tangentially involved in disseminating" misstatements (conduct the Court concluded would "typically be inappropriate" for liability)? *Lorenzo* leaves unanswered how lower courts will analyze "purpose, precedent, and circumstance" when evaluating potential disseminator liability and where the facts do not lead to such an obvious conclusion.

**Duty to Update Prior Public Statements**

Plaintiffs in securities fraud cases have recently notched similar wins in other areas that will likely prove significant in COVID19-driven disputes. One noteworthy example occurred in 2019, when the Supreme Court refused to hear an appeal of a Ninth Circuit decision holding a biopharmaceutical company had a duty to disclose new information relating to one of its prior disclosures regarding early results of clinical tests of one of its drugs.[1] While the previous disclosure was held to be "still technically accurate," the court found the company had a duty to disclose the new information because it "diminished" the "weight" and "value" of the previous disclosures. While the decision appears in tension with several other circuits, plaintiffs' attorneys will certainly argue the Supreme Court's decision not to review the case was tacit approval of the appellate court's significantly expanded approach to potential liability.

A company's "duty to update historical information" should cause companies making public disclosures to look closely at prior disclosures and, in consultation with counsel, make reasoned decisions regarding whether the prior disclosures should be updated. The need to review could be particularly acute in the COVID-19 and post-COVID-19 periods when constantly changing health and financial decisions are leading to uncertainty and turmoil in the market. Statements made during the early stages of the pandemic could have been "technically accurate," based on information available at that time, but are now either inaccurate or incomplete, based on recent developments or knowledge. These changes may be occurring on a daily, if not more frequent, basis. It may be prudent for a company to issue a clarifying disclosure that updates the prior disclosure for accuracy and completeness, while taking care to avoid an assertion that the initial disclosure was inaccurate or incomplete when made.

**Loss Causation**

One of the main battlegrounds of post-Mortgage Crisis securities fraud cases was loss causation. This followed the Supreme Court pronouncement in *Dura Pharmaceuticals Inc. v. Boudo* (2005) that a securities fraud suit is not an investor's insurance policy against market losses. Based on that concept, courts have consistently held plaintiffs could only recover losses caused by a defendant's misconduct, and not a global crisis in general. Many courts terminated Mortgage Crisis cases at the motion to dismiss and summary judgment phases because plaintiffs were unable to sufficiently plead or prove causation for misconduct that occurred during or shortly after the Mortgage Crisis.

We expect courts will continue this trend by, upon appropriate motion, dismissing cases in which plaintiffs have failed to sufficiently plead or prove that their losses were caused by the defendants' misconduct, rather than the COVID-19 Crisis in general. This will create challenges for plaintiffs and provide defendants with opportunities for early dismissal, when appropriate.

**COVID-19 Crisis "Public Disclosure" Cases Already Filed**

Underscoring the importance of the content of public statements in the current environment, on March 12, 2020, two "stock drop" shareholder class actions were filed – one against a pharmaceutical company and another against a cruise line. Both cases allege the defendant-companies made misleading public statements. Plaintiffs allege the cruise line's statement downplayed the company's financial risks posed by the pandemic, and the pharmaceutical company's disclosure included allegedly misleading statements regarding the company's purported progress in producing a vaccine.

The current financial crisis resulting from the COVID-19 pandemic is certain to result in a significant increase in securities fraud lawsuits and arbitration. Many of those cases will call into question the accuracy of public disclosures. Taking lessons from court rulings following the 2000 Technology Crash and the 2008 Mortgage Crisis should help companies more effectively navigate the anticipated securities litigation to come from the COVID-19 Crisis.

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