



INTRODUCTION TO SECURITIES LITIGATION

Preparing for increased securities-related disputes amid the COVID-19 pandemic

Eric Plourde
eric.plourde@procopio.com
619.906.5641

Agenda

- Basics of Securities Law
- Covid-19 and Securities Litigation
- Avoiding Securities Litigation
- First Steps After Being Sued
- Overview of Federal Securities Claims
- Overview of State Securities Claims
- Responding to SEC Inquiries
- FINRA Arbitrations
- Takeaways

Basics of Securities Law

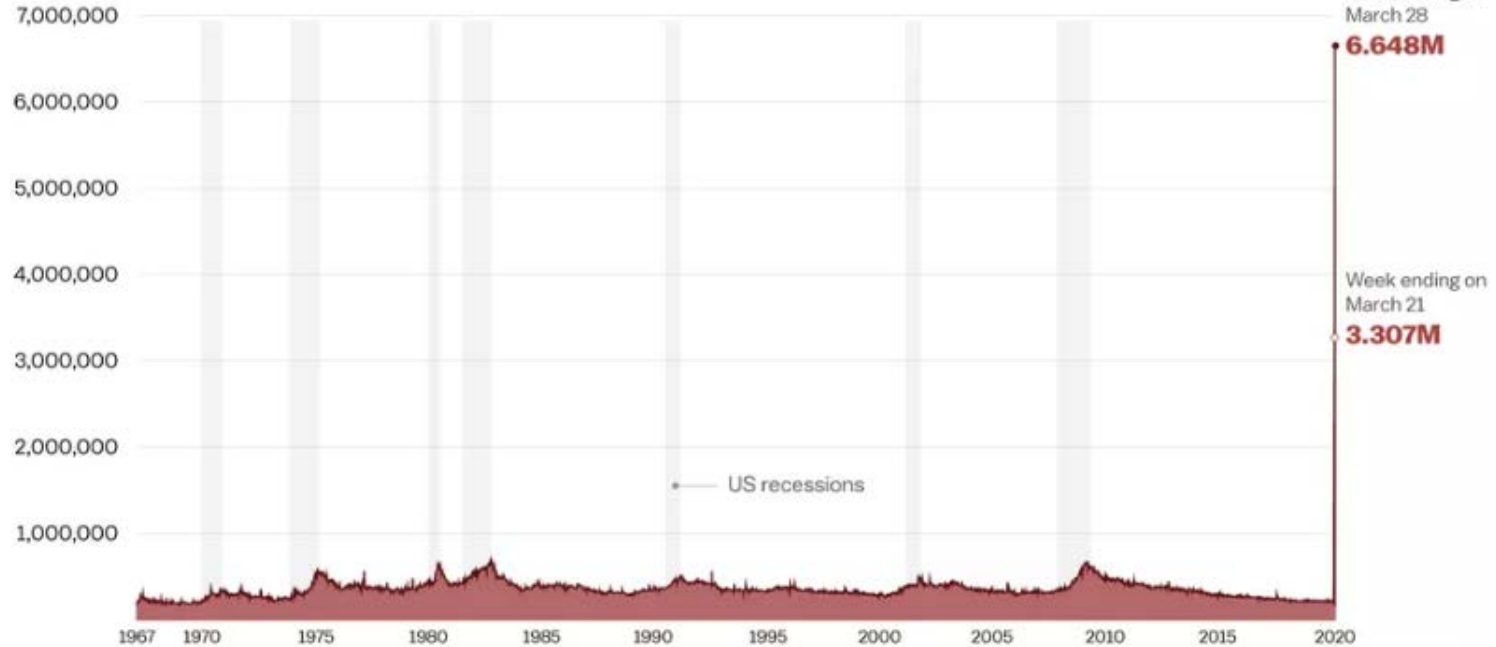
- **What is a security?**
 - “[A]ny note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security,” or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.”
 - 15 U.S.C. §77b(a)(1)
- **Translation**
 - A tradeable financial asset
 - Includes investment with hope of generating a return through the efforts of others

Basics of Securities Law

- Regulation
 - Federal Level
 - Securities and Exchange Commission (SEC)
 - Financial Industry Regulatory Authority (FINRA)
 - Licensing and Dispute Resolution Mechanisms
 - State Level
 - Blue Sky Laws

Covid-19 and Securities Litigation

Unemployment insurance claims by week



Covid-19 and Securities Litigation

Largest Daily Percentage Point Losses in History of Dow Jones Industrial Average

| Rank | Date | Close | Change | | |
|------|-------------------|-----------|-----------|--------|---------------------|
| | | | Net | % | |
| 1 | <u>1987-10-19</u> | 1,738.74 | -508.00 | -22.61 | (Black Monday) |
| 2 | <u>2020-03-16</u> | 20,188.52 | -2,997.10 | -12.93 | (Covid-19) |
| 3 | <u>1929-10-28</u> | 260.64 | -38.33 | -12.82 | (Great Depression) |
| 4 | 1929-10-29 | 230.07 | -30.57 | -11.73 | (Great Depression) |
| 5 | 2020-03-12 | 21,200.62 | -2,352.60 | -9.99 | (Covid-19) |
| 6 | 1929-11-06 | 232.13 | -25.55 | -9.92 | (Great Depression) |

Covid-19 and Securities Litigation

- Bloomberg Law
 - *“The Covid-19 pandemic and related market disruption will undoubtedly lead to shareholder class-action suits against publicly traded companies and their directors and officers.”*
- American Bar Association
 - *“Among the first suits to be filed, and certainly a hotbed of future disputes, are securities class actions involving COVID-19.”*
- Law 360
 - *“Investor scrutiny of company results is expected to intensify as corporate America's quarterly ritual of earnings calls followed by fuller regulatory disclosures heats up in the coming days and weeks...hazards remain for companies, which are susceptible to securities lawsuits in the event of a stock plunge.”*
- SEC → Formed Covid-19 Market Monitoring Group

Covid-19 and Securities Litigation

- SEC Enforcement Actions in 2008*
 - Citigroup’s principal U.S. broker-dealer subsidiary charged with misleading investors about a \$10 billion CDO tied to housing market in which Citigroup bet against investors as the housing market showed signs of distress. Settled for \$285 million.
 - Bank of America charged with defrauding investors with defrauding investors in an offering of residential mortgage-backed securities by failing to disclose key risks and misrepresenting facts about the underlying mortgages. Settled for \$245 million.
 - 204 Entities and Individuals Charged, including 93 Officers. More than \$1.93 billion in penalties.
- Class Actions in 2008**
 - 2008 saw ninety-nine financial crisis class action lawsuits filed, making up 47% of the 210 securities class actions registered in that year.

*See <https://www.sec.gov/spotlight/enf-actions-fc.shtml>.

**See PRICEWATERHOUSECOOPERS LLP, 2009 SECURITIES LITIGATION STUDY 6 (2009), available at http://10b5.pwc.com/PDF/NY-10-0559%20SEC%20LIT%20STUDY_V7%20PRINT.PDF.

Avoiding Securities Litigation

- Publicly Traded Companies
 - Financial Restatements
 - Good Audit and Tax firms a must
 - Press Releases
 - Presume materiality of anything released
 - Executive Liability
 - Avoid Suspicious Trades
 - Insider Trading; Clear Blackout Periods a Must
 - Follow SEC Guidance*
- Private Companies
 - Private Placement Offering Documents are Exhibit A
 - E-mail and other representations and projections are ripe for claims
 - Avoiding Committing to Timelines and Milestone Dates
- All Companies
 - Be Forthcoming
 - Obtain Insurance

*See, e.g., <https://www.sec.gov/news/press-release/2020-53>.

First Steps After Litigation Initiated

- Notify Insurers
- Obtain Competent Counsel
- Assess Indemnification Issues
 - Officers and Directors
- Assess Conflicts Issues
 - Can same counsel represent Company and management?
- Preserve Documents
- Prepare for a Long Process

Overview of Federal Securities Claims

- Securities Act of 1933
 - Primary Market
 - State or Federal Court (*Cyan*)
 - Claims
 - Sections 11 and 12
 - Control Person Liability
 - Section 15
- Securities Exchange Act of 1934
 - Secondary Market
 - Federal Court Only
 - Claims
 - Section 10(b)
 - Control Person Liability
 - Section 20(a)

Overview of Federal Securities Claims

- Rule 10b-5 Claims
 - Most Common Securities Fraud Claim
 - Elements
 - 1. A material misrepresentation or omission made in connection with the purchase or sale of a security;
 - 2. Scierter (pursuant to PSLRA);
 - 3. Reliance;
 - 4. Loss causation; and
 - *Law 360: As Investor Suits Tick Up, Loss Causation May Be A Hard Sell: “In the wake of the COVID-19 crisis, the number of securities cases filed in March and April has increased...But a volatile market may make it harder to prove fraud.”*
 - 5. Damages
 - Usually paired with a Section 20(a) claim for control person liability

Overview of Federal Securities Claims

- Private Securities Litigation Reform Act of 1995 (“PSLRA”)
 - Goal
 - Intended to curb perceived abuses and deter meritless claims
 - Key Provisions
 - Heightened Pleading Requirements
 - (1) Identification of each statement alleged to have been misleading with particularity.
 - (2) State facts giving rise to a strong inference of scienter.
 - (3) Adequately allege “loss causation”
 - Automatic Stay of Discovery Pending Motion to Dismiss
 - Limitations on Damages
 - E.g., 90-day look back rule, which “allows the security an opportunity to recover.” *In re Veritas Software Corp. Sec. Litig.*, 496 F.3d 962, 967 (9th Cir. 2007)

Overview of Federal Securities Claims

- Class Action Considerations
 - Securities Cases are Often Class Actions
 - PSLRA Requires Appointment of Lead Plaintiff and Lead Counsel
 - Lead Plaintiff Must Satisfy Rule 23(a) for Class Certification
 - Numerosity, commonality, typicality, adequacy
- Derivative Litigation
 - Filed on Behalf of the Company
 - Common Following Filing of Securities Claims
 - Tips to Minimize Expense
 - Seek Temporary Stay
 - Seek Consolidation
 - Abstention
 - Include in any Settlement

Overview of State Securities Claims

- “Blue Sky” Laws
 - Justice Joseph McKenna in *Hall v. Geiger-Jones Co.*, 242 U.S. 539 (1917)
 - *“The name that is given to the law indicates the evil at which it is aimed, that is, to use the language of a cited case, ‘speculative schemes which have no more basis than so many feet of ‘blue sky’; or, as stated by counsel in another case, ‘to stop the sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines and other like fraudulent exploitations.’”*

Overview of State Securities Claims

- California
 - Corp. Code § 25401
 - Originally modeled after federal Rule 10b-5.
 - Corp. Code § 25501
 - Creates private right of action for violation of Corp. Code § 25401
- Interplay with Federal Law
 - Federal law is generally persuasive authority*
 - Some Differences Exist
 - For example, scienter may not be required depending on circumstances**

**Moreland v. Dep't of Corp.* (1987) 194 Cal.App.3d 506, 512.)

**See *Brooks v. Tarsadia Hotels* (S.D. Cal., June 11, 2019) 2019 WL 2436395, at *15.)

Overview of State Securities Claims

- Other Rule 10b-5 Analogues
 - Nevada Securities Act → NRS 90.570 and 90.660
 - Arizona Securities Act → A.R.S. § 44-1991 and A.R.S. § 44-2002(A)
 - Texas Securities Act → Section 33 and Section 33-1
- Other State Law Claims
 - E.g., Sale of Unregistered Securities
 - Vary by Jurisdiction

Context of Federal and State Claims

– Commonly Federal Law Claims

- Publicly Traded Company
- Class Actions
- “Security” is Clear
 - E.g. stock
- Securities Fraud is the Primary Claim

– Commonly State Law Claims

- Private Companies/LLCs
- Not Class Actions
- “Security” is Less Clear
 - E.g. investment in LLC
- Securities Fraud Asserted with Other Claims (e.g. breach of fiduciary duty)

***Note:** Follow-on Derivative Litigation may occur in federal court, state court, or both, regardless of where the securities case is filed.*

SEC Investigations

Enforcement Division Investigation

- Two Stages
 - Informal Inquiry (“Matter Under Inquiry”)
 - Formal Investigation
- Possible Outcomes
 - No Further Action
 - Initiation of Civil Action
 - Referral to DOJ

Responding to SEC Requests

- Act Quickly
- Preserve Documents
- Reach out to SEC
- Negotiate Scope
 - But Proceed with Caution
- Be Cooperative/Transparent

Challenging an SEC Subpoena

- Possible but Rarely Successful

Securities Arbitrations

- FINRA (“Financial Industry Regulatory Authority”)
 - Private Self-Regulatory Organization
 - Provides Forum for Arbitration of Disputes with Advisors or Brokers
 - Common Claims
 - » Breach of Fiduciary Duty, Negligence, Misrepresentation, Omission of Facts, Unsuitability, Churning
- Process
 - Claimant Files Statement of Claim with FINRA
 - Two Procedural Codes (Customer Code or Industry Code)
 - Typical Time: 12-16 Months

Takeaways

- Covid-19
 - Likely to result in increase in securities-related disputes and investigations
- Federal Securities Claims
 - Most commonly will be 10b-5 claim
 - Pleading requirements/motion to dismiss very important
 - Focus on causation in Covid-19 era
 - Craft a strategy for follow-on derivative litigation
- State Securities Claims
 - Can be similar to federal claims, but differences may be important and vary by jurisdiction
- SEC Inquiries
 - Respond quickly; be cooperative; work with the SEC, not against it
- FINRA Arbitrations
 - Provide efficient mechanism for recourse against advisors/brokers

Thank you!



Eric A. Plourde

eric.plourde@procopio.com

619.906.5641

Questions? Please feel free to
contact me any time for guidance.