

Despite Last Year's Decline in Filings, Securities Litigation Will Likely Pick Up in 2022 Due to Plaintiffs' Continued Focus on SPAC Transactions and Event-Driven Litigation

Contributing Partners

Jay B. Kasner / New York

Scott D. Musoff / New York

Susan L. Saltzstein / New York

This article is from Skadden's 2022 Insights.

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West
New York, NY 10001
212.735.3000

Takeaways

- Despite a decline in securities class action filings in 2021, we saw a spike in SPAC-related lawsuits and continued activity in event-driven suits focused on issues of cybersecurity, the pandemic and cryptocurrency — trends we expect to continue in 2022.
- The Supreme Court ruled last year that defendants can introduce all relevant evidence at the class certification stage showing a lack of price impact, imposing new hurdles for plaintiffs, who must now address arguments that the alleged misstatements are too generic to have impacted the share price.
- As more state courts uphold federal forum provisions that require shareholders to file their 1933 Act claims in federal court, corporate defendants could be well positioned to avoid state court forums by including these terms in their charters.

For the second consecutive year, fewer securities class actions were filed in 2021 than in the prior year. However, we anticipate the pace of securities-related litigation to increase in 2022 as plaintiffs' securities firms continue to focus on cryptocurrency, special purpose acquisition company (SPAC) transactions, foreign issuers and so-called event-driven suits. Private litigation also is likely to get a boost as the Securities and Exchange Commission and Department of Justice pursue more aggressive regulatory and enforcement policies. (See "[DOJ Steps Up Corporate Criminal Enforcement, Looks More Broadly at Past Misconduct](#)" and "[SEC Expected To Introduce Host of New Rules in 2022, Enhance Enforcement](#).")

As we predicted early last year, suits involving SPACs rose in 2021, with 23 such cases filed through the third quarter, more than three times the total for all of 2020. This trend is likely to accelerate given the Delaware Court of Chancery's decision in *In re MultiPlan Corp. Stockholders Litigation*, which upheld claims for breach of fiduciary duty against a SPAC's sponsor and its directors and held them subject to the entire fairness standard of review where conflicts of interest and misleading disclosures were alleged. (See "[Delaware Courts Simplify Rules for Derivative Actions, Analyze SPAC Fiduciary Duty Review and Clarify](#)

[Books-and-Records Obligations](#)."") The court also allowed the plaintiffs' aiding-and-abetting claim to proceed against the SPAC's financial advisor. Considering the volume of SPAC transactions expected over the next year and the decision's potential to spur additional filings, more SPAC litigation is inevitable.

In a bullish stock market, we expect plaintiffs to rely on short-seller reports to assert claims, and we predict the continued use of the books-and-records statutes in Delaware and other states to obtain information to lay the groundwork for future securities actions.

On the other hand, as more companies add federal forum provisions to their corporate charters, we anticipate a continued decline in the number of parallel state and federal court 1933 Act filings.

Below we discuss select significant decisions and their potential impact on securities litigation in 2022.

Courts May Consider 'All Probative Evidence' at Class Certification in Evaluating Price Impact

In June 2021, the U.S. Supreme Court issued a decision that will continue to make class certification a fertile battleground in many securities lawsuits.

Arkansas Teacher Retirement System held that courts should consider “all probative evidence” at the class certification stage in assessing whether a defendant has rebutted the presumption of class-wide reliance recognized in *Basic Inc. v. Levinson*. The fact that the evidence may also be relevant to materiality later, when the claims are addressed on their merits, does not preclude its use in deciding if a class should be certified, the Court held. This includes evidence of the generic or aspirational nature of the alleged misstatements, which can be considered when evaluating price impact evidence.

In *Arkansas Teacher*, the plaintiffs alleged that the defendant investment bank and its executives made false and misleading statements about its conflict of interest policies. The statements allegedly maintained the bank's stock price at an inflated level until purported conflicts came to light.

In opposing class certification, the defendants argued that the alleged misstatements were too generic in nature to have any meaningful effect on the stock's price, defeating *Basic*'s presumption of classwide reliance. The Second Circuit refused to consider evidence of the generic nature of the statements, saying that would “really [be] a means for smuggling materiality into Rule 23,” and affirmed the lower court's class certification order.

The Supreme Court reversed and remanded. Clarifying its decisions in *Amgen v. Connecticut Ret. Plans & Trust Funds* and *Halliburton v. Erica P. John Fund* in 2013 and 2014, respectively, the Court said that, because the inflation maintenance theory asserts that a stock's “back-end price drop equals [its] front-end inflation,” the “generic nature of a misrepresentation often will be important evidence of a lack of price impact.” For instance, it said, “[W]hen the earlier misrepresentation is generic ... and the later corrective disclosure is specific ... it is less likely that the specific disclosure actually corrected the generic

misrepresentation, which means that there is less reason to infer front-end price inflation — that is, price impact — from the back-end price drop.”

However, the Court held that defendants bear not only the burden of production, but also the burden of persuasion by a preponderance of the evidence when seeking to rebut the presumption of reliance at the certification stage.

On remand, the Second Circuit vacated the class certification order and remanded the case to the district court, which then certified the class again. Applying the Supreme Court's new guidance, and weighing the parties' opposing expert evidence, it concluded that the “alleged misstatements were not so generic as to diminish their power to maintain pre-existing price inflation” and, therefore, had “some impact” on the price of the defendant's stock.

So, while the price maintenance theory survives another day and defendants now bear the burden of persuasion, the decision affirms an important right for defendants: For certification purposes, they can present all relevant evidence showing the absence of price impact.

State Courts Continue To Uphold Federal Forum Provisions

Last year's decline in filings can be attributed in part to a continued drop-off in the number of federal merger objection lawsuits filed as class actions, which fell to their lowest level since 2014. They had been a major contributor to overall filings since 2016. As *The D&O Diary* author *Kevin LaCroix* noted, while plaintiffs brought more merger objection suits in federal court in 2021 than in recent years, more were cast as individual rather than class actions. He suggested that this may be to avoid court scrutiny of “mootness fees” — sums corporate defendants pay to plaintiffs' counsel where the company has made supplemental disclosures that moot the plaintiffs' claims and the case is voluntarily dismissed.

Meanwhile, filings of 1933 Act claims in state courts also declined. This is in part due to the growing number of state courts that have enforced federal forum provisions (FFPs) in corporate charters requiring shareholders to bring their 1933 Act claims in federal court. In practice, these address the U.S. Supreme Court's 2018 decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, holding that state courts have jurisdiction to hear class actions under the 1933 Act, and that defendants cannot remove such cases to federal court. Last year, courts in New York and Utah upheld corporate charters containing FFPs, joining California and Delaware.

Because New York and California state courts have been forums for 1933 Act claims in recent years, corporations could be well positioned to avoid these forums by including FFPs in their charters. That said, changing the charter often requires shareholder approval, which may not be appropriate or viable in some cases. Since FFPs have not been universally adopted, we expect state court 1933 Act litigation to continue, albeit at lower levels than in previous years.

However, as a cautionary tale, in a January 7, 2022, decision the Seventh Circuit refused to enforce a company's bylaws containing a forum selection clause that required its shareholders to file their federal derivative claims under Section 14(a) of the Exchange Act in the Delaware Court of Chancery.

Because the forum bylaw would “force plaintiff to raise its claims in a Delaware state court, which is not authorized to exercise jurisdiction over Exchange Act claims” the court concluded it would “foreclose entirely plaintiff's derivative action under Section 14(a).” While acknowledging that Delaware law grants corporations “considerable leeway” in drafting their bylaws, the court concluded it “does not empower corporations to use such techniques to opt out of the [Exchange Act of 1934].”

Judge Frank Easterbrook dissented, opining that there was “no problem” with plaintiff litigating its derivative suit alleging Section 14(a) claims in state court. Section 14(a) “does not say one word about enforcement” and its judicially created private right of action permits investors (not issuers) to sue. Because nothing in the bylaw prevents a plaintiff from filing a direct action in federal court, plaintiff has not been “deprived” of any right to enforce Section 14(a). Regarding the Exchange Act’s “supposed exclusivity of jurisdiction,” Congress has “told us that derivative suits related to securities matters may begin in state court” and “stay there” since these suits cannot be removed. And Section 27(a) of the act does not change this result because derivative suits arise under state law “even if a federal issue may come to the fore” and that section’s right to exclusive federal jurisdiction is waivable.

Ninth Circuit’s *Pirani* Decision Arguably Creates Split Regarding Section 11 Actions

Ruling on an issue of first impression, the Ninth Circuit held in September 2021 in *Pirani v. Slack Technologies, Inc.* that shareholders have statutory standing to bring claims under Sections 11 and 12(a) (2) of the 1933 Act arising from a direct listing. In its motion to dismiss, Slack argued that Pirani, who purchased shares during the company’s direct listing, lacked standing because he could not prove his shares were traceable to the registration statement.

In a 2-1 decision, the Ninth Circuit affirmed the lower court’s denial of Slack’s motion to dismiss, holding that both the registered and unregistered shares in the direct listing were sufficiently traceable to the registration statement to satisfy the 1933 Act’s standing requirements. The

court expressed concern that a contrary reading of Section 11 would leave investors without recourse against misrepresentations made in direct listings, undermining its remedial purpose.

But as Judge Eric D. Miller’s dissent observed, other circuit courts and prior Ninth Circuit precedent have interpreted Section 11 narrowly, to apply only to securities issued pursuant to a registration statement and directly traceable to that statement.

Slack has filed a petition for rehearing *en banc* and, if unsuccessful, we expect it will file a petition for *certiorari* to the U.S. Supreme Court to address the apparent split in the circuits.

Event-Driven Lawsuits Focused on Issues of Cybersecurity and COVID-19

Keeping with trends from recent years, plaintiffs have continued to file “event-driven” securities class actions, where the catalyst is the disclosure or occurrence of a significant event that negatively impacts the stock price, often unrelated to the company’s financial results. This year saw more pandemic-related suits as well as cases stemming from cybersecurity breaches.

Companies have faced an onslaught of cyberattacks, giving rise to suits alleging material misstatements or omissions with respect to the strength of companies’ cybersecurity systems. These suits do not appear to have gained much traction and have tended to end in dismissals or settlements. Courts have found that companies’ extensive disclosures about the risks of hacking and data breaches were sufficient warning to investors, and that generic statements about the risks were unlikely to be misleading or indicate knowledge of specific, ongoing breaches.

The pandemic continued to drive new filings, as well, with 11 COVID-19-related securities cases through September 30, 2021. Most of the actions filed in 2020 alleged that companies failed to prepare adequately for the effects of a pandemic or overstated their resilience. By contrast, last year brought suits alleging that companies like home exercise and networking businesses overstated the sustainability of their growth during the pandemic, or that pharmaceutical companies overstated the efficacy of their treatments.

These cases demonstrate that companies should continue to pay particular attention to their disclosures that could be affected by COVID-19, as well as its secondary and tertiary impacts (including supply chain, employment and other issues).

In addition, 2021 brought more securities class actions involving cryptocurrencies, where plaintiffs alleged misrepresentations in initial coin offerings or the sale of unregistered securities by token issuers and asset exchanges.

ESG Litigation

Lastly, we note the emerging trend of shareholders using litigation as a tool to further environmental, social and corporate governance (ESG) goals. Securities and Exchange Commission officials have also made it clear they will make ESG disclosures a priority. We expect more ESG-related suits to follow as issuers pay greater attention to these issues and make more statements about their efforts. (See “[Activism Landscape Continues To Evolve](#)” and “[Investors Press for Progress on ESG Matters, and SEC Prepares To Join the Fray.](#)”)