

Securities Litigation: Spotting Trends, Reducing Risk, and Building a Defense

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Types of Securities and Shareholder Claims

- Stock-drop-based securities fraud claims
- Transaction-based securities claims
- Event-based securities claims
- Derivative and fiduciary duty claims

Recent Securities and Shareholder Claims

Stock-drop-based securities fraud claims

- *Douglas v. Norwegian Cruise Lines*, 20-cv-21107 (S.D. Fla.), alleging:
 - February 20, 2020 Form 8-K provided misleadingly positive outlook despite COVID-19 outbreak
 - February 27, 2020 10-K failed to disclose fraudulent sales tactics, incl. false statements about impact on cruise industry, to induce customers to continue or maintain bookings
 - Practices revealed by March 11, 2020 *Miami New Times* leak of employee emails—company's shares fell 26.7%, then 35.8%

Recent Securities and Shareholder Claims

Transaction-based securities claims

- *Lombard v. Portola Pharmaceuticals, Inc., et al.*, 20-cv-00769 (D. Del.), alleging:
 - Violations of Sections 14(d), 14(e) of Exchange Act against company and Board in connection with merger with Alexion
 - Schedule 14D-9 filed with SEC on May 27, 2020 omitted or misrepresented material information regarding Merger
 - Company significantly undervalued its shares due to market volatility caused by COVID-19, which did not reflect true value of the company

Recent Securities and Shareholder Claims

Event-based securities claims

- *McDermid v. Inovio Pharmaceuticals et al.*, 20-cv-1402 (E.D. Pa.), alleging:
 - Company and CEO made false, misleading statements to market, claiming company had successfully developed COVID-19 vaccine and anticipated rapidly bringing it to market
 - CEO later admitted that Inovio had not developed fully fledged vaccine
 - Announcement came on day of \$50 million stock offering, dropping stock price from high of \$19.36 to \$5.70 per share

Recent Securities and Shareholder Claims

Derivative and fiduciary duty claims

- *Beheshti v. Kim*, No. 20-cv-1962 (E.D. Pa.), alleging:
 - CEO, other executives artificially inflated stock price by telling public in financial filings and March 2 televised meeting with then-President Trump that Inovio's coronavirus vaccine was developed 3 hours after obtaining virus' genome sequence, and could be tested on humans by April
 - CEO later admitted that Inovio had developed only construct, not fully fledged vaccine, causing company's stock price to plummet
 - Breach of fiduciary duty, gross mismanagement, unjust enrichment and other claims against eight company directors, including CEO

Trends and Risk Forecasts

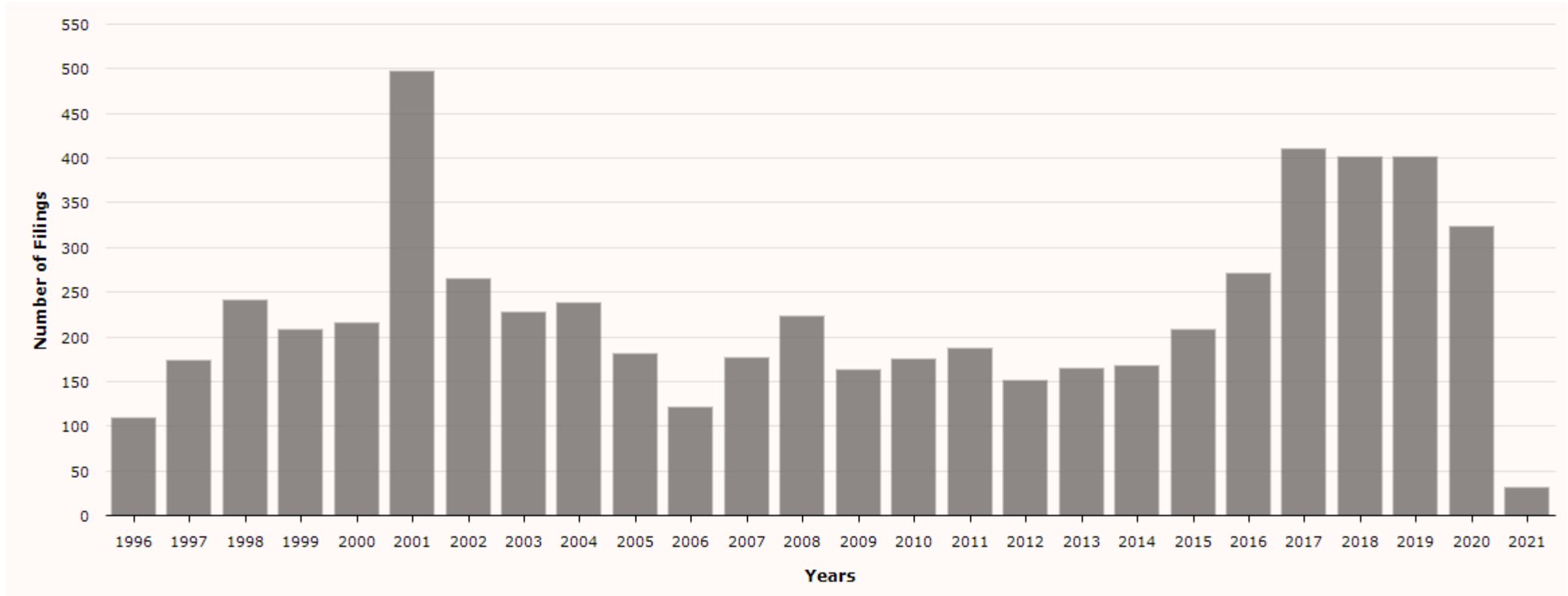
Volatility spiked and topped out in Q1 2020



VIX CBOE MARKET VOLATILITY
February 2020-2021

Trends and Risk Forecasts

Securities filings are down – but maybe not to surprising degree



Source: Stanford Law School Securities Class Action Clearinghouse
(in collaboration with Cornerstone Research)

Trends and Risk Forecasts

Premiums are up for D&O insurance, driven by uncertainties around COVID-19 and increased settlement payments

MARKET UPDATE AND YEAR-OVER-YEAR (YOY) RATE FORECAST

PRODUCT LINE	Q2 2020	Q4 2020-2021
EXECUTIVE & PROFESSIONAL RISK (EPS)		
Public Company Directors & Officers	Up 25% to 75%	Up 20% to 100%
Private Company and Not-For-Profit (NFP) Directors & Officers	Up 10% to 50%	Up 10% to 60%
Employment Practices Liability (EPL)	Up 10% to 50%	Up 15% to 60%
Fiduciary	Up 10% to 25%	Up 5% to 50%
Crime	Up 10% to 25%	Up 10% to 30%
Professional Liability/Errors & Omissions	15% to 50%	Up 10% to 50%

USI 2020-2021 COMMERCIAL PROPERTY & CASUALTY MARKET OUTLOOK

Risk Mitigation: Fulsome Disclosures

- Best way to mitigate risk is to make fulsome and accurate disclosures
- SEC Div of Corp. Fin. released non-exhaustive list of questions to assess effects of COVID-19 and disclosure obligations, incl. impact on/from:
 - Financial condition and results of operations
 - Capital and financial resources, incl. overall liquidity position and outlook
 - Assets on balance sheet and ability to timely account for those assets
 - Material impairments (e.g., goodwill and other intangible assets, investment securities), increases in allowances for credit losses, restructuring charges, other expenses
 - Remote work arrangements and ability to maintain operations, incl. financial reporting systems, internal control over financial reporting and disclosure controls and procedures
 - Challenges in implementing business continuity plans or material expenditures to do so
 - Demand for products or services
 - Supply chain or the methods used to distribute products or services
 - Constraints or other impacts on human capital resources and productivity
 - Travel restrictions and border closures and ability to operate and achieve business goals

Risk Mitigation: Examples of COVID-19 Related Disclosures

Multinational Tech Company's 2020 10-K mentioned COVID 47 times, incl. broad disclosure:

General Risks

The continuing impacts of COVID-19 are highly unpredictable and could be significant, and may have an adverse effect on our business, operations and our future financial performance.

Since COVID-19 was declared a global pandemic by the World Health Organization, governments and municipalities around the world have instituted measures in an effort to control the spread of COVID-19, including quarantines, shelter-in-place orders, school closings, travel restrictions, and closure of non-essential businesses. The macroeconomic impacts on our business continue to evolve and be unpredictable and may continue to adversely affect our business, operations and financial performance. As a result of the scale of the ongoing pandemic and the speed at which the global community has been impacted, our revenue growth rate and expense as a percentage of our revenues in future periods may differ significantly from our historical rate, and our future operating results may fall below expectations.

The future impacts of the ongoing pandemic on our business, operations and future financial performance could include, but are not limited to:

- Significant decline in advertising revenues as advertiser spending slows due to an economic downturn. This decline in advertising revenues could persist through and beyond a recessionary period. In addition, we may experience a significant and prolonged shift in user behavior such as a shift in interests to less commercial topics.
- Significant decline in other revenues due to a decline or shifts in customer demand. For example, if consumer demand for electronics significantly declines, our hardware revenues could be significantly impacted.
- Adverse impacts to our operating income, operating margin, net income, EPS and respective growth rates - particularly if expenses do not decrease across "Company" at the same pace as revenue declines. Many of our expenses are less variable in nature and/or may not correlate to changes in revenues, including costs associated with our data centers and facilities as well as employee compensation. As such, we may not be able to decrease them significantly in the short-term, or we may choose not to significantly reduce them in an effort to remain focused on long-term outlook and investment opportunities.

- Significant decline in our operating cash flows as a result of decreased advertiser spending and deterioration in the credit quality and liquidity of our customers, which could adversely affect our accounts receivable. Investing cash flows could decrease due to slowing spend on data center and facilities construction projects due to a slowing or stopping of construction or significant restrictions placed on construction.
- The prolonged and broad-based shift to a remote working environment continues to create inherent productivity, connectivity, and oversight challenges and could affect our ability to enhance, develop and support existing products and services, detect and prevent spam and problematic content, hold product sales and marketing events, and generate new sales leads, among others. In addition, the changed environment under which we are operating could have an effect on our internal controls over financial reporting as well as our ability to meet a number of our compliance requirements in a timely or quality manner. Additional and/or extended, governmental lockdowns, restrictions or new regulations could significantly impact the ability of our employees and vendors to work productively. Governmental restrictions have been globally inconsistent and it remains unclear when a return to worksite locations or travel will be permitted or what restrictions will be in place in those environments. As we prepare to return our workforce in more locations back to the office in 2021, we may experience increased costs as we prepare our facilities for a safe return to work environment and experiment with hybrid work models, in addition to potential effects on our ability to compete effectively and maintain our corporate culture.

Risk Mitigation: Examples of COVID-19 Related Disclosures

Global Equipment Company's Q3 2020 10-Q included disclosures:

Company's forecasts for the markets in which it operates slightly improved during the three months ended September 30, 2020, but continued to reflect an overall decline in economic conditions resulting from a contracting economy, elevated unemployment rates and an increase in delinquencies due to the COVID-19 pandemic. The company believes the economic forecasts employed represent reasonable and supportable forecasts, followed by a reversion to long term trends.

Response to COVID-19 and Global Business Conditions:

Operational Status

Company continues to implement safeguards in its facilities to protect team members, including increased frequency of cleaning and disinfecting, social distancing practices and other measures consistent with specific regulatory requirements and guidance from health authorities.

As of mid-October 2020, globally and across Company's three primary segments, nearly all of the company's primary production facilities continued to operate. This continues to fluctuate as conditions warrant, including the pace of economic recovery and the potential for additional COVID-related temporary shutdowns.

The company has continued to take actions to reduce costs and prioritize its spending to provide for investment in services and expanded offerings, key elements of its strategy for profitable growth, which was introduced in 2017.

Risk Mitigation: Examples of COVID-19 Related Disclosures

Large bank's Q3 2020 10-Q mentioned COVID 124 times, including broad disclosures

Coronavirus Disease 2019

The COVID-19 pandemic has caused a significant global economic downturn that has adversely affected, and is expected to continue to adversely affect, the Corporation's businesses and results of operations, and the duration and future impacts of the COVID-19 pandemic on the U.S. and/or global economy and the Corporation's businesses, results of operations and financial condition remain uncertain.

These negative economic conditions may have a continued adverse effect on our businesses and results of operations, which could include, but not be limited to: decreased demand for and use of our products and services; protracted periods of historically low interest rates; lower fees, including asset management fees; lower sales and trading revenue due to decreased market liquidity resulting from heightened volatility; increased noninterest expense, including operational losses; and increased credit losses due to our customers' and clients' inability to fulfill contractual obligations and deterioration in the financial condition of our consumer and commercial

borrowers, which may vary by region, sector or industry, that may increase our provision for credit losses and net charge-offs. Our provision for credit losses and net charge-offs may also continue to be impacted by volatility in the energy and commodity markets. Additionally, our liquidity and/or regulatory capital could be adversely impacted by customers' withdrawal of deposits, volatility and disruptions in the capital and credit markets, volatility in foreign exchange rates and customer draws on lines of credit. Continued adverse macroeconomic conditions caused by COVID-19 could also result in potential downgrades to our credit ratings, negative impacts to regulatory capital and liquidity and further restrictions on dividends and/or repurchases of our common stock, which could limit the capital we return to shareholders.

If we become unable to operate our business from remote locations including, for example, because of an internal or external failure of our information technology infrastructure, we experience increased rates of employee illness or unavailability, or governmental restrictions are placed on our employees or operations, this could also have an adverse effect on our business continuity status and result in disruption to our businesses.

Risk Mitigation: Market Volatility Relating to “Meme” Stocks

- SEC Div. of Corp. Fin. issued guidance on securities offering disclosures during times of “extreme price volatility,” characterized as:
 - recent stock run-ups or divergence in value,
 - high short interest or reported short squeezes, and
 - reports of strong and atypical retail investor interest, including on social media
- SEC provided sample comment letter, requiring an issuer to address:
 - recent price volatility and any known risks of investing under these circumstances
 - comparative market prices before and after the volatility
 - whether any recent changes in financial condition or results of operations are consistent with the stock price changes

Risk Mitigation: Measuring Goodwill Impairment

- Message from SEC: Show, Don't Just Tell
 - In response to claim of no impairment to goodwill, SEC told company to demonstrate that business's fair value substantially exceeds carrying value of each operating segment

Notes to Condensed Consolidated Financial Statements (Unaudited)

Goodwill and Other Intangible Assets, net, page 15

1. We note your disclosure that, due to general market declines driven by the coronavirus global pandemic, you performed impairment testing on your goodwill and indefinite-lived intangible assets. In both cases, you determined that the fair values of these assets exceeded their carrying value.

In order to provide investors with information to better assess the probability of future goodwill impairment charges, please disclose, if accurate, that the estimated fair values of the intangible assets you quantitatively tested for impairment *substantially* exceeded their carrying values. For any asset whose estimated fair value did not substantially exceed its carrying value, please disclose the percentage by which fair value exceeded carrying value at the date of the most recent test.

Risk Mitigation: “Going Concern” Qualifications

- In June 2020, SEC issued Coronavirus (COVID-19) — Disclosure Considerations Regarding Operations, Liquidity, and Capital Resources
- SEC instructed companies to consider company’s ability to continue as going concern:
 - Are there conditions and events that give rise to the substantial doubt about the company’s ability to continue as a going concern? For example, have you defaulted on outstanding obligations? Have you faced labor challenges or a work stoppage?
 - What are your plans to address these challenges? Have you implemented any portion of those plans?

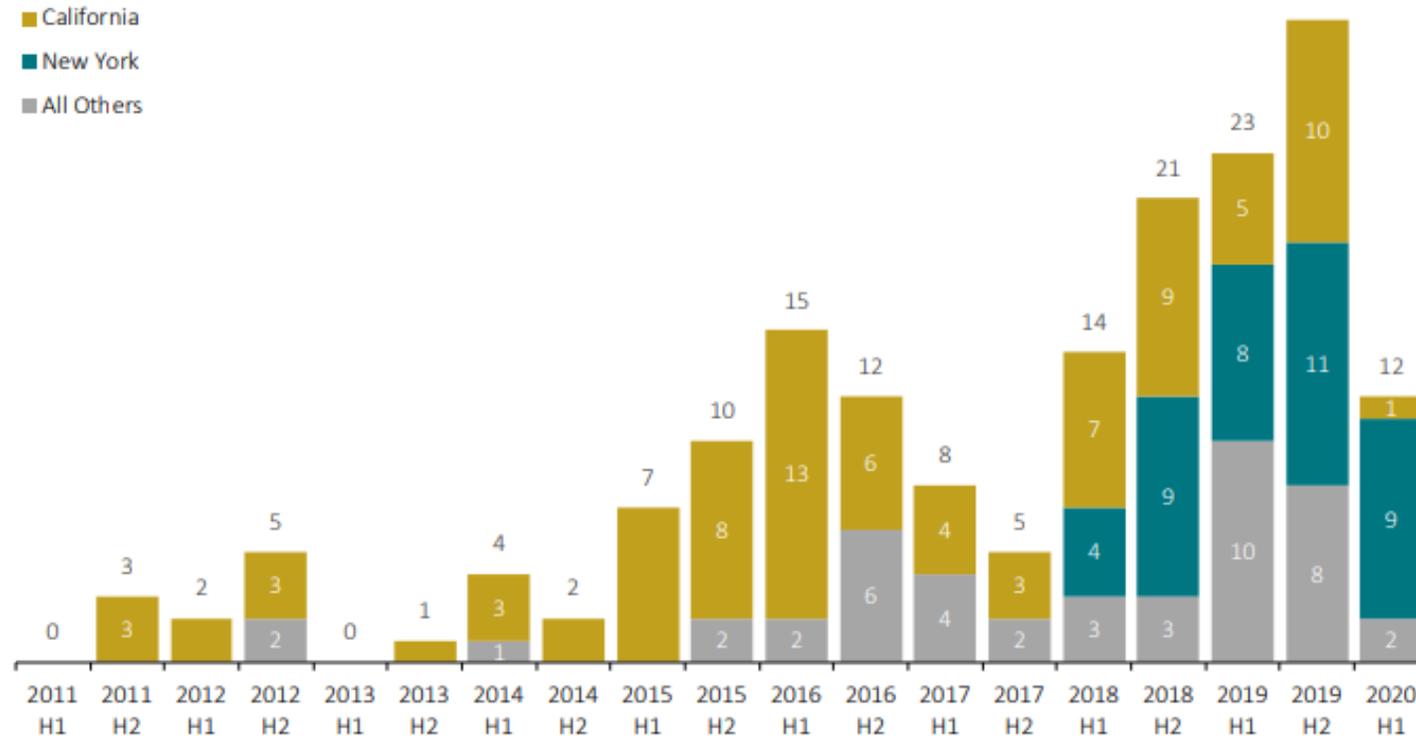
Risk Mitigation: Item 303 “Trend” Disclosures

- In November 2020, SEC amended Reg S-K to simplify MD&A disclosure requirements
 - Companies required to evaluate known trends or uncertainties that registrant reasonably expects will have material impact (favorable or unfavorable) on net sales or revenues or income from continuing operations
 - Where trend is known, management must make two assessments:
 - (1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.
 - (2) If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant’s financial condition or results of operations is not reasonably likely to occur.

Risk Mitigation: Forum Clauses

'33 Act Filings in state court declined significantly in California, but remained steady in New York

Figure 13: State 1933 Act Filings by State
2011 H1–2020 H1



Risk Mitigation: Forum Clauses

- Delaware forum clause for intra-corporate claims
 - Generally enforceable
- Delaware Supreme Court held federal forum provisions valid under Delaware law to limit Securities Act claims to federal court, *Salzberg v. Sciabacucchi*, 227 A.3d 102, 116 (Del. 2020)
- Model forum clause language from the DE Supreme Court:
 - “Unless the Company consents in writing to the selection of an alternative forum, the federal district courts of the United States of America shall be the exclusive forum for the resolution of any complaint asserting a cause of action arising under the Securities Act of 1933. Any person or entity purchasing or otherwise acquiring any interest in any security of [the Company] shall be deemed to have notice of and consented to [this provision].”
- Aim to be proactive about bylaw amendments to incorporate these terms
 - If you wait until litigation hits, it’s probably too late as the clause may be unenforceable

Enforcement Trends: COVID-19 Related Enforcement Priorities

- SEC created in March 2020 COVID-19 Steering Committee to detect and address areas of potential misconduct related to pandemic, incl.:
 - COVID-19 Related Misconduct; Financial Statement/Issuer Disclosure Fraud; Microcap Fraud; Insider Trading and Market Manipulation
- Examples of COVID-19 Related Enforcements:
 - Applied Biosciences Corp. – alleged false, misleading claims regarding distribution of rapid result finger-prick COVID-19 tests to public
 - Praxsyn Corp., CEO – alleged false, misleading claims of ability to acquire and supply large quantities of N95 masks
 - Turbo Global Partners, Inc., CEO – alleged false, misleading claims regarding purported partnership to sell thermal scanning equipment to detect fever

Enforcement Trends: Disclosure-based Enforcement

- Timely, complete disclosures regarding financial condition prior to pandemic, incl. in light of representations made in PPP certifications
 - PPP applicants required to certify “current economic uncertainty makes this loan request necessary to support the ongoing operations”
- Using pandemic to mask issues affecting financial condition
- Focus on other disclosures about effect of pandemic or financial condition overall
 - SEC v. Cheesecake Factory – 1st charge against public co. for misleading investors about pandemic impact on business operations, financial condition (Dec. 4, 2020)

Enforcement Trends: Expected Uptick

- Under new administration, uptick in enforcement activity is expected
- Enforcement activity was already trending upwards:
 - SEC Enforcement Division opened 1,181 new inquiries and investigations in FY 2020, compared to 1,082 in prior year
 - In FY 2020, SEC Whistleblower Office received over 6900 tips, complaints and referrals, > 30% increase over next highest year (FY 2018)

Best Practices for Litigation Defense

- Brief Directors and Officers on litigation and the need to be sensitive in communicating on related topics
- Coordinate closely with external communications and investor relations teams
- Preserve documents
 - Critical to distribute hold notice and implement document hold procedures immediately, as these cases tend to be document-intensive

Thank You!

- Questions?



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