SECURITIES SIDEBAR

THE LATEST SECURITIES LITIGATION NEWS FROM BLOCK & LEVITON

BLOCK & LEVITON CLIENT SECURES LEADERSHIP IN NIKOLA SECURITIES LITIGATION AFTER TRIP TO NINTH CIRCUIT

An important question always facing an investor when deciding to seek appointment as a lead plaintiff is whether to go it alone or join a group. The law, at times, can be quite muddled with different District Judges coming to different decisions. In the Nikola Securities Litigation we took a long-shot appeal of a decision by a District Judge who, essentially said, he did not like groups and refused to appoint a group of investors, including our client, who lost 9 times as much as the investor who was appointed as the Lead Plaintiff. The Ninth Circuit Court of Appeals accepted the appeal, reversed the District Court and sent the case back where the lower court appointed the group as the Lead Plaintiff.

Nikola is a purported hydrogen truck company that went public in a SPAC transaction. Its CEO, Trevor Milton, hyped Nikola's stock in an unrelenting barrage of public statements on social media and drove Nikola's valuation up over $8 billion. After a short report exposed the company as a fraud, the hype unraveled, the stock price plunged, and Milton was indicted for criminal securities fraud. His trial is pending. Leadership in a case of this magnitude is very important.

Our clients were part of a group that lost over $6 million. The District Court found our group lost the most of any movant, were typical and adequate investors but the court had "misgivings" about appointing a group and, instead, appointed an investor who lost about $700,000. Rarely does a securities plaintiff appeal a district court's decision appointing a lead plaintiff under the PSLRA, and even more rarely does a securities plaintiff succeed with such an appeal. This is because the only practical recourse is a petition for writ of mandamus, but mandamus relief is only available for clear errors of law, and the standard of review applied to the district court's decision is whether the lower court abused its discretion. Indeed, the PSLRA's lead plaintiff selection framework directs courts to assess the adequacy and typicality of the plaintiff with the largest financial interest and then to determine whether any other plaintiff proffers evidence to successfully rebut a statutory presumption in favor of that movant. When the statute is properly applied, both inquiries are discretionary in nature. Nonetheless, we appealed.

The United States Court of Appeals for the Ninth Circuit granted our clients' petition for writ of mandamus and vacated the district court's order appointing another plaintiff to lead the securities class action against Nikola. In re Mersho, 6 F.4th 891 (9th Cir. 2021). The district court then applied the Ninth Circuit's instructions on remand and appointed our clients lead plaintiff and Block & Leviton co-lead counsel. It was a significant victory for our clients: a group of three investors who individually held the largest, second largest, and fourth largest losses of any movant seeking to lead the class action; collectively they lost over $6 million. It was also an exceptional victory, born from our recognition that the circumstances were ripe for mandamus relief.

The Ninth Circuit's holding in In re Mersho reiterated that despite district courts' wide latitude in what information they can consider to assess a given plaintiff's adequacy, the PSLRA's lead plaintiff selection analysis follows a rigid and straightforward process. In this vein, factors such as a group's prelitigation relationship (or lack thereof), a group's size, how the group members found their counsel, and the group's working procedures for managing the litigation can all be considered in the adequacy analysis, but the PSLRA's legal standard for adequacy remains whether the group can "fairly and adequately protect the interests of the class"—it is not a test of relatedness.

Mersho will aid investors who decide to work together as Lead Plaintiffs. It reaffirms that having small groups of investors band together to prosecute securities cases is not only allowed, but can be quite beneficial to the class as a whole. It will also dissuade district courts in the Ninth Circuit from implementing (official or unofficial) blanket prohibitions on lead plaintiff groups whose members have no relationship that predates the litigation.

INSIDE THIS ISSUE

DELAWARE DEVELOPMENTS IN 2021

The courts of Delaware spent all of 2021 operating under various degrees of COVID-related restrictions. But that didn't slow down the pace of litigation or blockbuster legal developments in the First State, which is the corporate home of most publicly traded companies.

The news out of Delaware this year was a mixed bag. We'll start with the bad news, then end on a positive note with a couple of significant highlights.

BAD NEWS:
THE SUPREME COURT ELIMINATES DIRECT CHALLENGES TO DILUTIVE SHARE ISSUANCES AND SLIGHTLY TIGHTENS THE DEMAND-FUTILITY ANALYSIS

By far, the most disappointing news out of Delaware in 2021 was the Delaware Supreme Court's decision in Brookfield v. Rosson, which overruled fifteen years of precedent holding that public investors could challenge unfairly priced, dilutive share issuances to controlling stockholders through both direct and derivative claims. In Brookfield, the Court held that these relatively common and often high-value claims could only be litigated derivatively (i.e, on behalf of the company, rather than a class of investors).

This was an unfortunate development for several reasons. Most importantly, derivative claims can survive a motion to dismiss only if shareholders can plead "demand futility": facts showing that a majority of Board members would be unable to give independent and disinterested consideration to a demand that the company bring suit on its own behalf. This is often a challenging exercise as the Court is, at times, reluctant to conclude that even the most docile directors are conflicted, absent material financial ties to a controller or unusually strong social relationships. And even when shareholders are able to survive a motion to dismiss, boards will sometimes form a special litigation committee—often comprised of newly appointed directors—in an attempt to seize back control of the litigation. Finally, derivative claims can be more risky than direct claims because a stockholder has to maintain continuous ownership of at least one share throughout the proceeding. If the company is sold or goes bankrupt during the proceeding, shareholders can lose standing.

The other disappointing news from Delaware came in another Delaware Supreme Court decision issued just three days after Brookfield. In United Food & Commercial Workers Union & Participating Food Industry Employers Tri-State Pension Fund v. Zuckerberg, the Supreme Court tightened the demand-futility test slightly. Specifically, some earlier decisions by the Court of Chancery had held that investors could show demand futility simply by alleging facts showing that a challenged transaction was subject to a stricter standard of review because a controlling stockholder stood on both sides of the deal or because of other conflicts. In Zuckerberg, however, the Court rejected this line of case law and held that the only way to overcome the demand requirement is showing, on a director-by-director basis that half or more of the directors (1) "received a material personal benefit from the alleged misconduct," (2) "would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand," or (3) "lack independence from someone who received a material personal benefit from the alleged misconduct … or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand." As the Supreme Court emphasized, this is a "refine[ment]" of existing law that is largely "consistent" with existing case law. But defendants will no doubt argue—both in Delaware and in other courts around the country that look to Delaware for guidance on corporate law—that this reflects a far more dramatic sea change in the law that justifies ignoring old, favorable case law. We are skeptical that this approach will work but it is still too early to say how other courts will respond.

GOOD NEWS:
REPORTS OF CAREMARK'S DEATH ARE GREATLY EXAGGERATED AND CHANCERY GIVES CORPORATE COUNSEL A WAKE-UP CALL

The news wasn't all bad. On the positive side, 2021 showed that the Court of Chancery is increasingly willing to hold corporate directors accountable for violations of their duty of oversight to ensure that the company complies with positive law. These claims (also known as Caremark claims) have traditionally been described as the "hardest claim in all of corporate law." And until recently, the Court of Chancery had only sustained a handful of Caremark claims at the motion-to-dismiss stage, many of which involved small companies and serious criminal wrongdoing by senior executives.

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Then, in 2019, the Delaware Supreme Court broke new ground in Marchand v. Barnhill by, for the first time ever, reversing a pleading-stage dismissal of a Caremark claim. Marchand held that the stockholder plaintiff had adequately alleged oversight claims against the Board of Blue Bell Creameries arising from a listeria outbreak in its ice cream manufacturing plants. The court highlighted that Blue Bell was "a monoline company that makes a single product—ice cream—" and could "only thrive if its consumers enjoyed its products and were confident that its products were safe to eat." But the Board "had no committee overseeing food safety, no full board-level process to address food safety issues, and no protocol by which the board was expected to be advised of food safety reports and developments."

In 2021, the Court of Chancery dealt with a wave of post-Marchand motions to dismiss in Caremark cases. While most were still dismissed, the Court issued a blockbuster opinion in the Boeing derivative litigation brought against Boeing officers and directors in connection with the two tragic crashes of the company's 737 Max airplanes in October 2018 and March 2019. Appling Marchand, the Court upheld Caremark claims against Boeing directors based on allegations that they had failed to create an airplane safety committee, monitor and discuss airplane safety on a regular basis, or establish protocols requiring management to give updates regarding airplane safety. As a result of these oversight failures, several "red flags" that came to management's attention never made it to the Board. Within a couple of months of the Court's decision, plaintiffs announced that they had reached a $237.5 million settlement with Boeing's directors as part of a package that also included substantial corporate governance reforms. The second highlight of 2021 came close to the end of the year. In mid-November, the Court of Chancery entered a post-trial ruling in Bandera Master Fund v. Boardwalk Pipeline Partners, finding that Boardwalk's controller, Loews Corporation, had breached Boardwalk's partnership agreement in a take-private transaction and awarding the class of public investors $690 million in damages, plus statutory interest and attorneys' fees. The key conclusion on which the Court's ruling turned was that a legal opinion from Loews' outside counsel at Baker Botts—which was necessary to allow Loews to force the transaction through—was not issued in good faith. The Court concluded that Baker Botts "knowingly made unrealistic and counterfactual assumptions, knowingly relied on an artificial factual predicate, and consistently engaged in goal-directed reasoning to get to the result that Loews wanted."

While this ruling has been appealed to the Supreme Court, it has already sent shockwaves through the corporate bar. Boardwalk will almost certainly cause most corporations to shy away from obtaining Delaware law opinions from non-Delaware lawyers for the foreseeable future. And it has served as a clear warning shot that Delaware courts are willing to hold prominent corporate law firms accountable for misconduct.

THE BRIEFING BOOK DOESN'T LIE: LITIGATION AGAINST PHARMACEUTICAL COMPANIES OFTEN FOLLOWS FDA'S DISCLOSURE OF YEARS-OLD COMPANY/ AGENCY INTERACTIONS

The U.S. Food & Drug Administration has a longstanding policy of keeping confidential its interactions with drug developers during clinical trials, only releasing information close to the time it decides whether to grant or deny approval of a new drug. This policy is in place even when a drug company directly misrepresents its interactions with the agency to the public. As a result, drug developers are free to discuss positive aspects of their FDA interactions while leaving out the bad in the hope that the drug will eventually be approved and no one will be the wiser. Block & Leviton has been involved in several securities fraud cases against drug companies who are eventually revealed to have been misrepresenting their years-long interactions with the FDA.

To obtain approval for a new drug, the FDA requires sponsors to submit a New Drug Application, or NDA (or, in the case of biologics, a Biologics License Application). The goals of the NDA are to provide enough information to permit FDA reviewers to reach key decisions, including whether the drug is safe and effective in its proposed use(s), and whether the benefits of the drug outweigh the risks. This information is primarily supplied by data from three clinical trial phases conducted in the years leading up to the NDA filing.

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Prior to making a final decision on a particular NDA, the FDA will often designate an advisory committee to hold a meeting regarding the NDA and make a recommendation on approval to the FDA. When this occurs, the advisory committee releases a Briefing Book in advance of the meeting. The Briefing Book contains detailed information about the clinical trials as well as the FDA's interactions with the sponsor. While the FDA makes the final decision on approval, the agency almost always follows the recommendation of the advisory committee. As a result, investors find the information contained in Briefing Books to be strong indicators of a drug candidate's prospects for approval.

When the FDA elects to hold an advisory committee meeting, the release of the Briefing Book can reveal that a drug company had been making misleading statements about their interactions with the FDA – statements that would have otherwise gone unnoticed. This is what happened to Trevena Inc. in 2018, and more recently to Reata Pharmaceuticals, Inc. In both instances, the companies had been making positive statements about the FDA's purported agreement with their clinical trial designs – statements that were directly contradicted by the FDA's description of their interactions with the companies contained in the Briefing Books. In 2021, Block & Leviton recovered $8.5 million on behalf of investors in Trevena.

When the Briefing Book reveals that the FDA had strong disagreements with the drug developers on key elements of the clinical trials, the company's share price often plumets, causing large losses to investors who were under the impression that these companies enjoyed FDA support. After the release of the Briefing Book for Trevena, an analyst from Jefferies stated in reaction to the news: "To our surprise, TRVN proposed endpoint for assessing respiratory safety burden was not supported by the FDA, and this information was not disclosed to the public following the end-of-phase 2 FDA meeting." In the case of Reata, an analyst from SVB Leerink aptly stated: "The bardoxolone [Reata's drug candidate] saga highlights the pitfalls of relying on a management team's characterization of what the FDA has said they will require for the approval of a drug."

Fraud revealed as the result of the release of FDA Briefing Books has led to calls for the FDA to revise its policy of remaining silent even when a company is clearly misrepresenting their interactions with the agency. Unless and until that change occurs, drug companies will be free to mischaracterize their prospects for approval, leaving investors in the dark until it is too late.

SEC EXPECTED TO ISSUE NEW ESG REGULATIONS IN 2022

Since taking charge of the Securities and Exchange Commission (SEC) in April last year, SEC Chair Gary Gensler has espoused support for an ambitious regulatory agenda, including new rulemaking. Based on statements by Gensler, other commissioners, and recent agency actions, it looks increasingly likely that 2022 will be the year the SEC formally proposes new regulations requiring additional corporate disclosures across a range of environmental, social, and governance (ESG) issues.

New disclosures on climate change appear to be a top priority, with board diversity, human capital, and cybersecurity following closely behind. While the specific content of the expected draft regulations has yet to be determined, the public response to the SEC's March 2021 request for comments on climate-related disclosures suggests broad support for mandating the disclosure of factors "material" to business operations, as well as the quantification and reporting of both direct and indirect greenhouse gas emissions. The SEC is also considering mandating disclosures relating to the diversity of corporate boards, metrics relating to workforce turnover, compensation, skills and training, and cybersecurity risk management.

There is some reason to be skeptical that new rules are imminent. The agency missed its stated goal of issuing new proposed rules for climate disclosures by the end of 2021 and there have been reports about the rulemaking process getting slowed down by internal debates about the particulars of what the SEC should require. But Chairman Gensler's consistent support for getting new rules out for public comment, the agency's public rulemaking agenda, and increasing pressure from activists, investors, the White House and Congress, all point towards additional agency action this year.

Any newly proposed rules requiring additional ESG disclosures will have to be voted on by the SEC Commissioners, traverse the public notice and comment process, and survive potential, but expected, legal challenges before taking effect. Many investors, non-governmental stakeholders and boards are not waiting for the SEC to finalize new rules before pushing for additional transparency and accountability around ESG issues. For example, a recent PwC research survey found that 75% of respondents felt "companies should address ESG issues, even if doing so reduces short-term profitability" and that "reducing direct carbon emissions from a company's operations" was the most cited response when it came to which ESG issues respondents thought companies should prioritize.

2021 SECURITIES LITIGATION UPDATE:
THE SUPREME COURT'S DECISION IN GOLDMAN SACHS HAS NOT HELPED DEFENDANTS

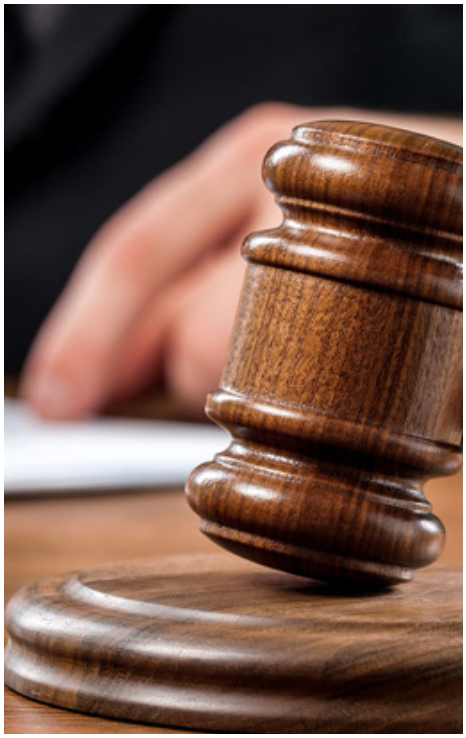
Justice Barrett's first foray into securities-fraud class actions as a member of the Supreme Court was met with excitement by the defense bar, who thought the case would make an excellent vehicle to introduce additional risk to plaintiffs at the class certification stage of a case. The excitement was tempered by the reality that the Goldman case was, essentially, a big yawn. The majority opinion in Goldman Sachs v. Arkansas Teacher Retirement System is remarkable, principally, for how little it changed and, so far, the application of Goldman by lower courts seems to have done little to help defendants seeking to prevent the certification of class actions brought by investors.

In Goldman Sachs, the plaintiff alleged that the financial behemoth's misrepresentations included public statements that the firm "[had] extensive procedures and controls that are designed to identify and address conflicts of interest," its "clients' interest always come first," and "integrity and honesty are at the heart of our business." Pointing to a drop in the price of Goldman's stock following the announcement of an action brought by the Securities and Exchange Commission based on an alleged conflict of interest, plaintiff moved for class certification based on the theory that Goldman's misstatements had inflated the price of its stock, and the price had declined when the truth was revealed.

Following two sojourns to the Second Circuit, the Supreme Court granted certiorari to address two issues: whether generic statements alleged as misrepresentations were relevant to the question of whether there was "price impact," and, whether Defendants have to carry the burden of persuasion to prove a lack of price impact to defeat class certification.

On the second question, the Court made clear that it is indeed Defendants' burden to prove a lack of price impact to defeat class certification. On the former question, the Supreme Court remanded the case to the Second Circuit for further consideration, noting that while there may be some overlap between evidence relevant to both price impact and merits issues, courts should assess "all probative evidence," including the so-called generic nature of alleged misstatements, when considering price impact at class certification.

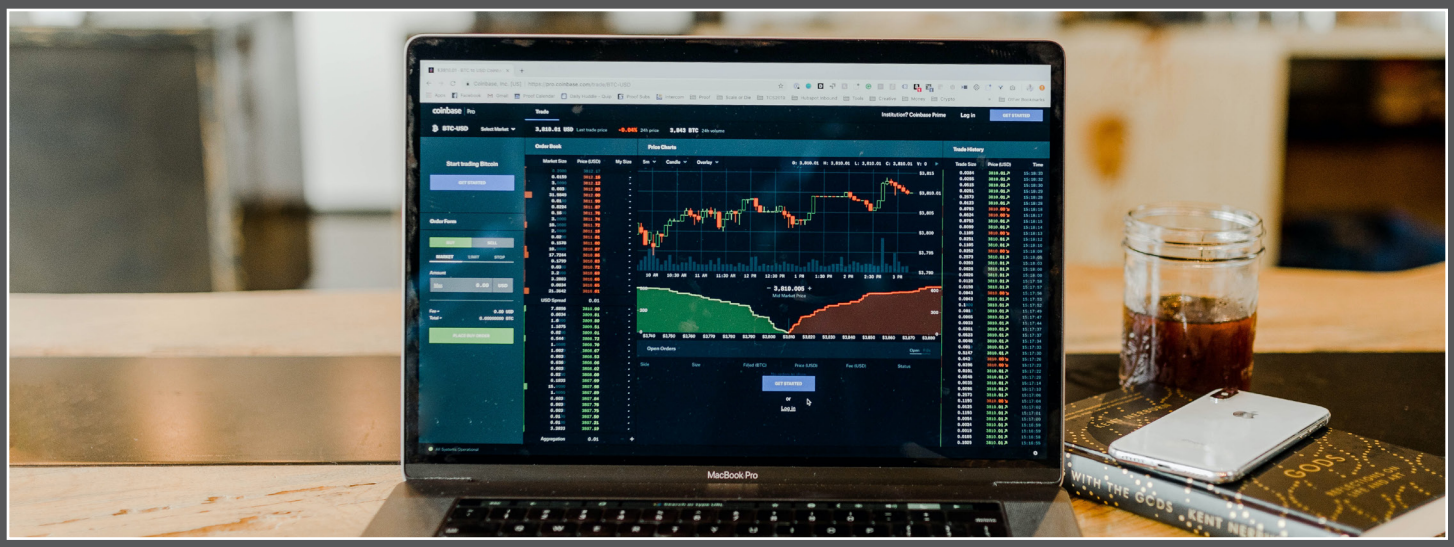
Defendants have latched onto dicta in Justice Barrett's decision concerning the potential for a "mismatch" between the generic nature of alleged misstatements at the specific corrective disclosures that end a class period. But Defendants have yet to marshal this "mismatch" theory to any pending class certification decisions. In In re Mattel, Inc. Securities Litigation, a case where Block & Leviton served as counsel, the Central District of California outright rejected Mattel's claim that Goldman precluded reliance on a particular stock



drop, agreeing with the argument that the highly specific financial statements at issue in that case were nothing like the generic representations at issue in Goldman.

Defendants in In re Apple Inc. Securities Litigation, were similarly disappointed when the Northern District of California applied Goldman. Analyzing the link between Apple's alleged misrepresentations about its business in China and later stock drops, the court concluded that Apple's attempts to show a mismatch were unconvincing and granted class certification. The court in Brokop v. Farmland Partners Inc. reached a similar conclusion, finding that Goldman's theoretical discussion of a potential mismatch had little application where a plaintiff alleged misrepresentations by omission.

None of this should be surprising. Justice Barrett's opinion in Goldman left the background doctrine essentially unchanged. Notably, on remand, even the District Court in Goldman again certified the class, finding that Plaintiffs had "persuasively established a link between the public revelations concerning Goldman's conflicts of interest and the subsequent stock price declines. In short, while Defendants in securities class actions will almost certainly continue to make much of alleged mismatches between misstatements and disclosures, so far at least, those arguments haven't been enough to evade class certification.



2022 SECURITIES LITIGATION PREVIEW:
WILL THE 9TH CIRCUIT ALLOW SECTION 11 CLAIMS AGAINST COMPANIES WHO DIRECTLY LISTED THEIR SHARES TO PROCEED?

We expect the Ninth Circuit, and potentially the Supreme Court, to address the question of whether a company who lists its shares directly, rather than engaging in a traditional initial public offering, can avoid liability under Section 11 of the Securities Act for untrue statements or omitting material facts.

Most companies that go public do so through an IPO. But in 2018, the NYSE instituted a rule that allowed companies to go public through a so-called direct listing. In a direct listing, a company does not issue any new shares and instead files a registration statement solely for the purpose of allowing existing shareholders to sell their shares on the exchange. Shares sold in a direct listing are sold directly to the public, rather than through banks that underwrite traditional IPOs.

In Pirani v. Slack Technologies, Inc., the question of whether companies who engage in dirtect listings still face Section 11 liability came before the courts. In Slack, an investor alleged violations of Section 11 on behalf of a class of investors who acquired Slack stock pursuant and/or traceable to the allegedly misleading registration statement issued in connection with the Company's direct listing. Slack moved to dismiss, arguing, in part, that plaintiff lacked standing under Section 11 because he could not determine whether he had purchased registered or unregistered shares in Slack's non-traditional direct listing. The district court denied Slack'sstanding argument, butcertified Slack's request for interlocutory appeal because the question of whether shareholders can establish standing under Section 11 in connection with a direct listing was a matter of first impression.

The Ninth Circuit granted Slack's petition for interlocutory appeal, and in a 2-1 decision, affirmed the district court's ruling with respect to the Section 11 claims. The Court found that adopting Slack's interpretation would undermine the purposes of Section 11. Because applying Section 11 only to registered shares in direct listings would eliminate liability in direct listings that sell both registered and unregistered securities, "it is unclear why any company, even one acting in good faith, would choose to go public through a traditional IPO if it could avoid any risk of Section 11 liability by choosing a direct listing." As evidence that the direct listing rules were not intended to create a massive end-run around Section 11 liablity, the majority cited the SEC's order approving amendments to the NYSE's direct listing rule in which the SEC cited the district court opinion in Slack to assuage concerns that traceability issues would prevent plaintiffs from pursuing Section 11 claims in the direct listing context.

What is next? Slack has filed a petition for rehearing en banc, i.e., for the entire Ninth Circuit to reconsider the issue. The Defense bar has marshaled multiple amici curiae to submit briefs in support of Slack's petition. Meanwhile, agroup of twelve of the largest U.S. public pension funds have also submitted an amicus brief urging the Ninth Circuit not to disturb its opinion. Whether or not the Ninth Circuit agrees to hear the case en banc, a petition to the Surpeme Court is almost certain to follow.

Direct listings have not been common yet, but at least one other case is affected by the Slack decision. In In re Coinbase Global, Inc. Securities Litigation, currently pending in the Northern District of California, Coinbase has preserved the question pending further developments in the law. We expect that companies are watching closely and that a reversal here would see the number of direct listings increase. As the majority in Slack aptly stated, "it is unclear why any company, even one acting in good faith, would choose to go public through a traditional IPO if it could avoid any risk of Section 11 liability by choosing a direct listing." Such a reversal would severely curtail the investor protections afforded by Section 11 for nearly 90 years.