

# Morgan Lewis

## **GLOBAL PUBLIC COMPANY ACADEMY**

### **SECURITIES LITIGATION AND TRUSTEE LITIGATION UPDATE: WHAT PUBLIC COMPANIES AND D&Os SHOULD KNOW**

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# Presenters



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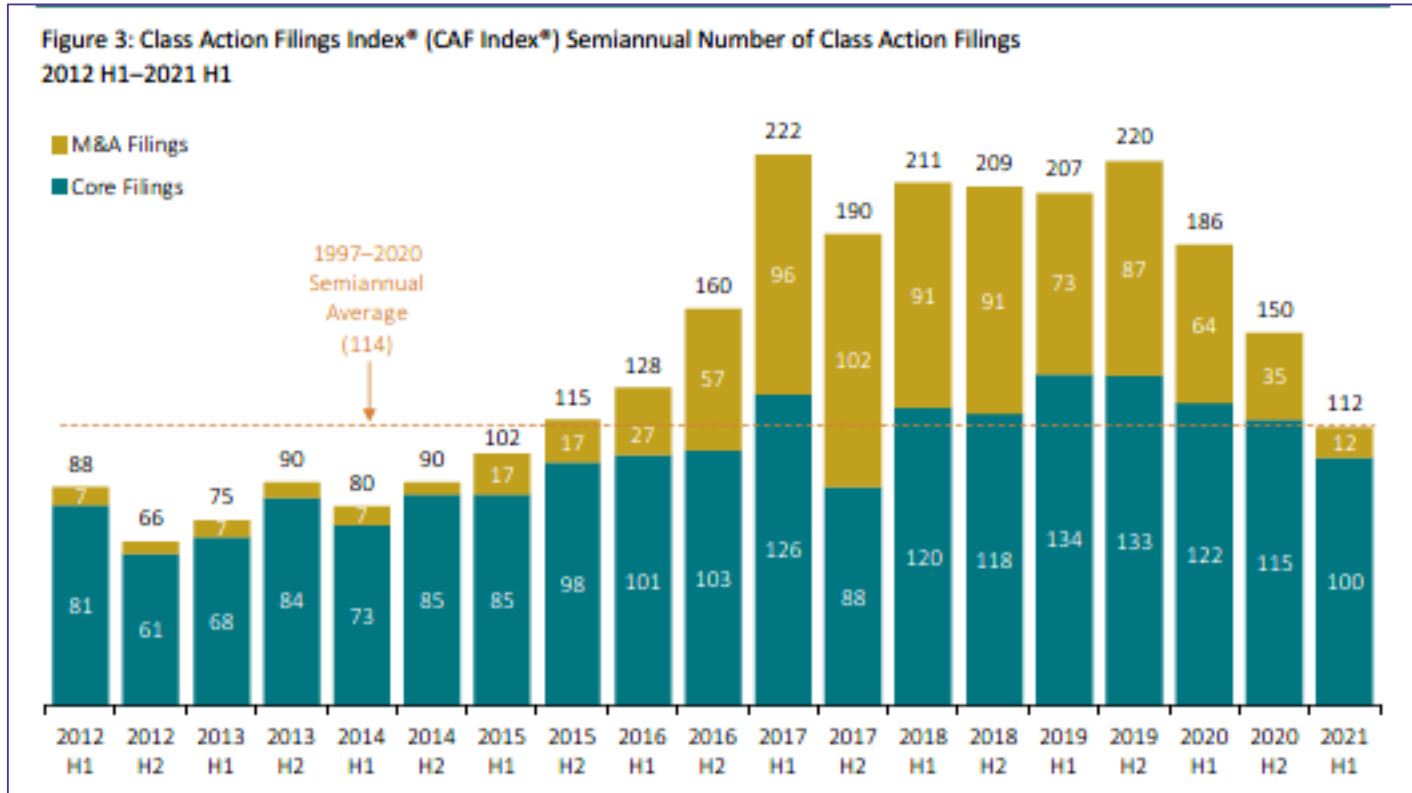
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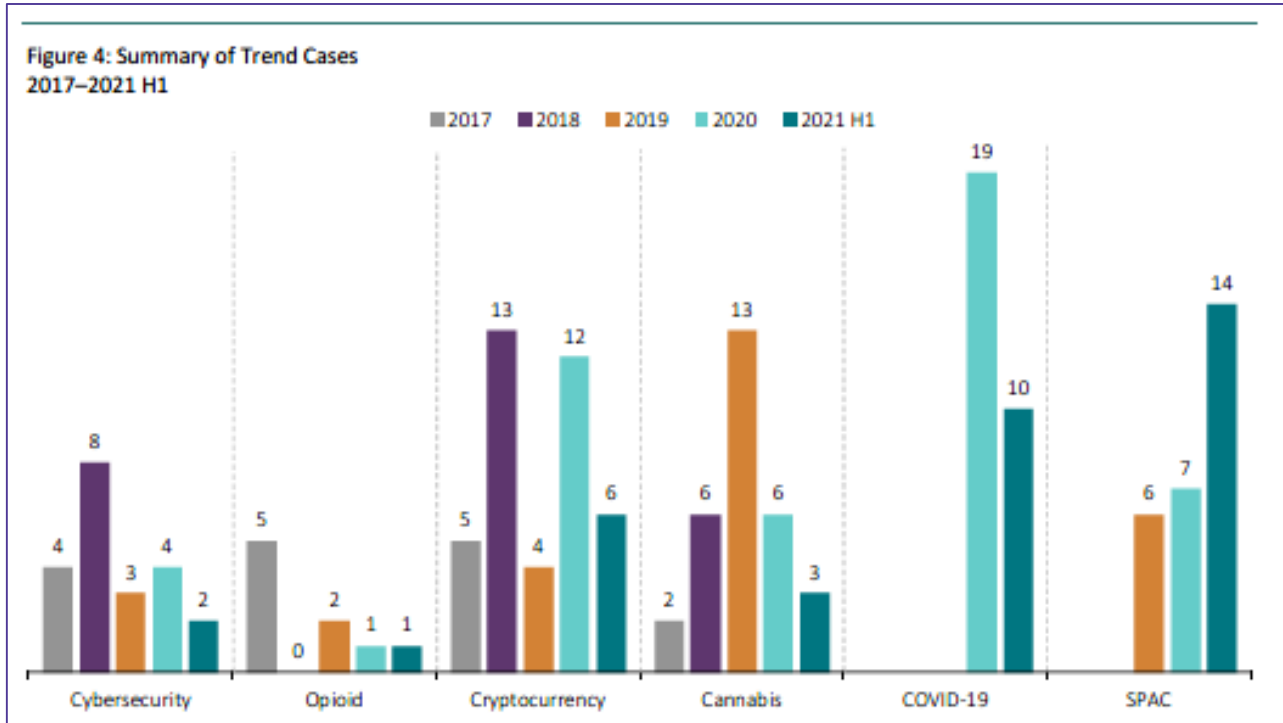
# TRENDS IN SECURITIES LITIGATION

# Overall: A Decrease in Filing Activity



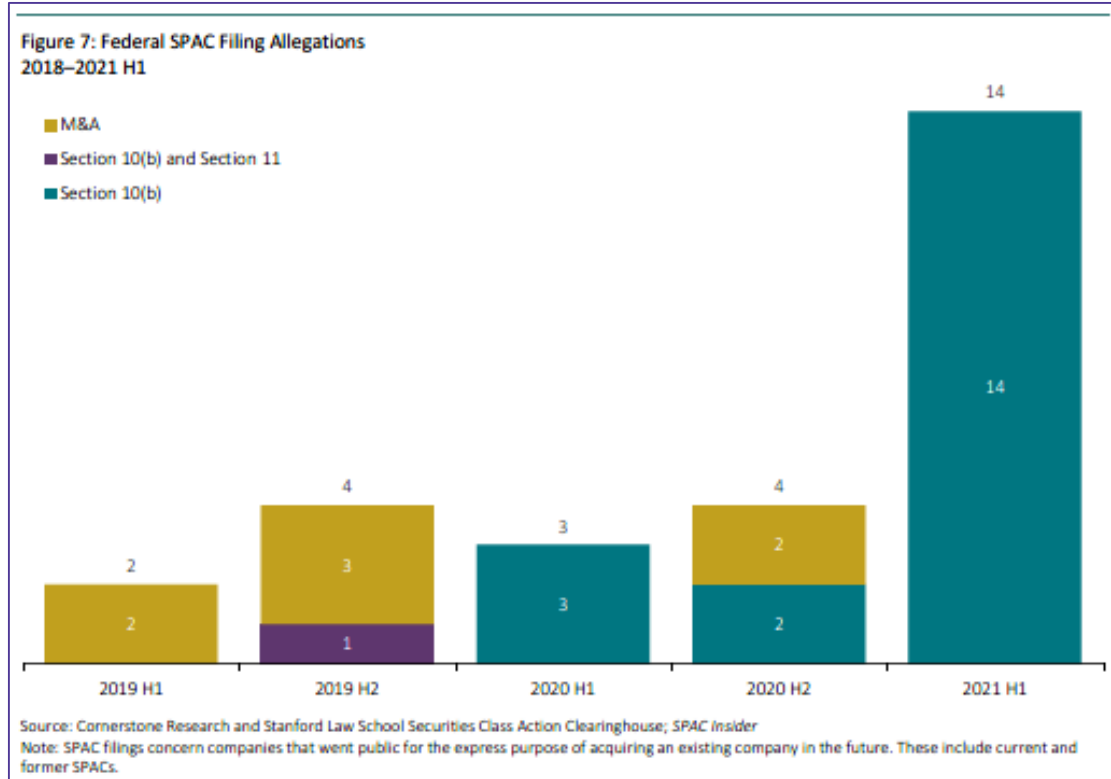
Securities Class Action Filings, 2021 Midyear Assessment, CORNERSTONE RESEARCH (2021)

# What's HOT in Securities Litigation?



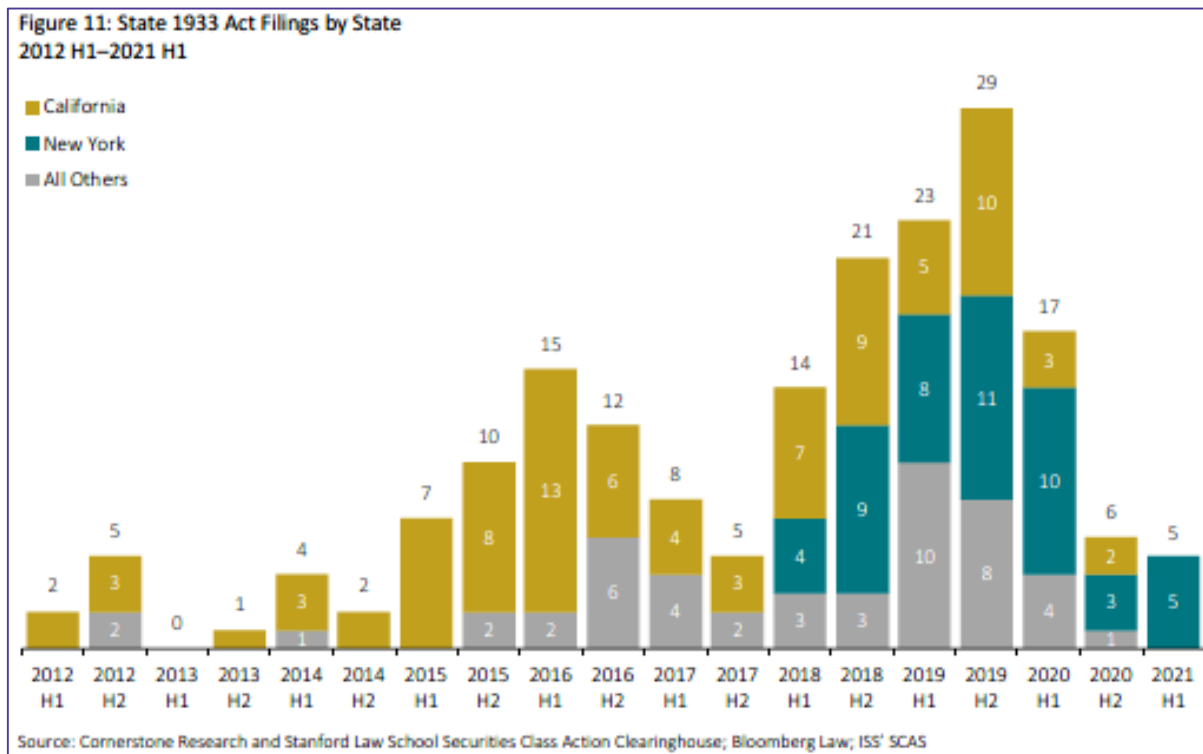
*Securities Class Action Filings, 2021 Midyear Assessment, CORNERSTONE RESEARCH (2021)*

# SPAC Filings UP



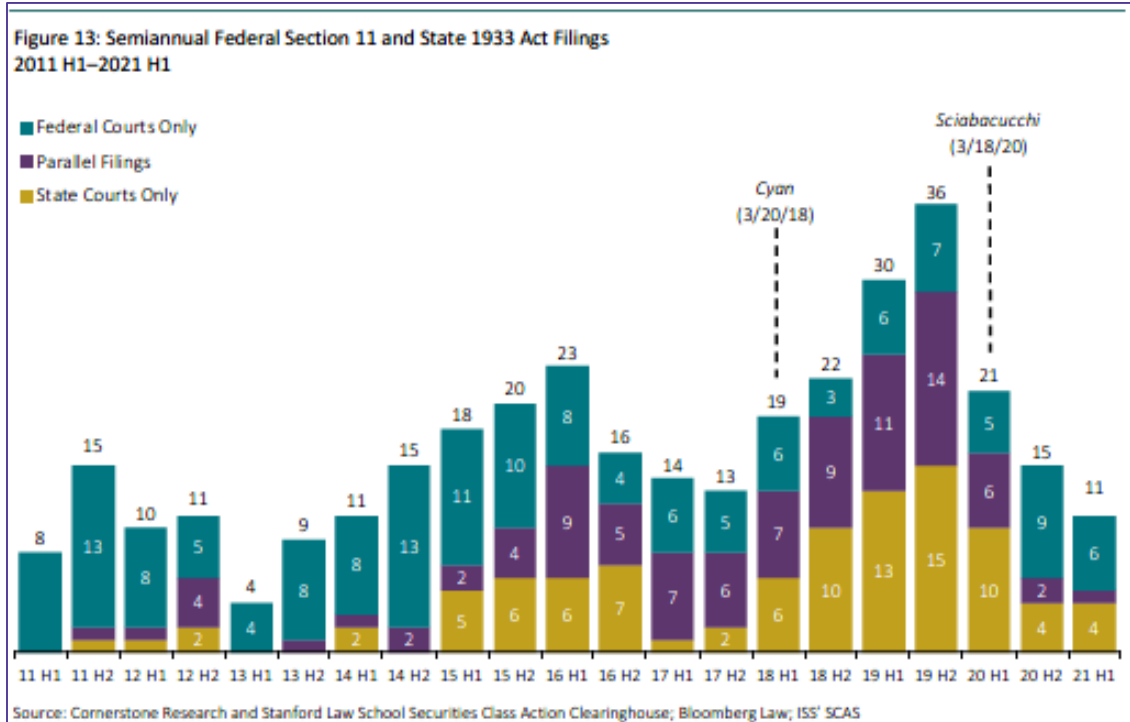
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# 1933 Act Cases Filed in State Courts DOWN



Securities Class Action Filings, 2021 Midyear Assessment, CORNERSTONE RESEARCH (2021)

# State 1933 Act Filing Activity Remains Depressed Post-*Sciabacucchi*



Securities Class Action Filings, 2021 Midyear Assessment, CORNERSTONE RESEARCH (2021)



# But First: The Supreme Court's Decision in *Cyan*

- In 2018, the US Supreme Court held in *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018), that both state and federal courts have concurrent jurisdiction over claims brought under the Securities Act of 1933, as amended (the Securities Act)—most often misstatements or omissions in registration statements or prospectuses.
- The *Cyan* decision prompted a significant shift in the securities litigation landscape, as plaintiffs increasingly filed Securities Act claims in state court, in part to evade the procedural protections of the Private Securities Litigation Reform Act of 1995 (the PSLRA).
- Often there are parallel cases brought in federal court against the same defendants based on the same alleged misstatements.

# The Delaware Supreme Court's Decision in *Salzberg v. Sciabacucchi*

- In *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. Mar. 18, 2020), the Delaware Supreme Court rejected a challenge to the validity of the following forum provision adopted in the corporate charters of three Delaware companies prior to their IPOs:

“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].”

# The Delaware Supreme Court's Decision in *Salzberg v. Sciabacucchi*

- In affirming the facial validity of these exclusive federal forum provisions (FFPs), the court explained that such a provision could provide corporations with certain efficiencies in managing these claims, including consolidation of multijurisdictional litigation and the avoidance of state court forum shopping. There is also merit to the notion that federal courts are best suited to apply federal securities laws, given their expertise and intimate familiarity with this body of law.
- That case provides some relief for Delaware corporations that have recently issued securities, or that plan to do so, if they have federal-forum charter provisions in place.
- The reach of *Sciabacucchi*, and the extent to which section 11 cases continue to be litigated in state court, will depend on a number of factors, most importantly the extent to which states in which these cases are litigated treat FFPs as valid.
  - Courts in NY and CA have found that FFPs are valid and enforceable. *E.g.*, *Wong v. Restoration Robotics, Inc.*, No. 18CIV02609 (Cal. Super. Ct. Sept. 1, 2020); *Hook v. Casa Sys., Inc. et al.*, No. 654548/2019 (NY Sup., Aug. 31, 2021).

# Considerations for Incorporating Exclusive FFPs

- Litigating Securities Act claims exclusively in federal court has numerous benefits
  - Reduced costs and inefficiencies in multijurisdictional litigation
  - Avoidance of state court forum shopping
  - Experienced federal forum
  - Forum predictability
- Proxy advisors' positions:
  - Prior to *Salzberg*, Glass Lewis and ISS had mixed views on forum-selection clauses, generally reflecting the need for a case-by-case determination
  - Now ISS will generally recommend a vote “for federal forum selection provisions in the charter or bylaws that specify ‘the district courts of the United States’ as the exclusive forum for federal securities law matters,” but against provisions that select a particular federal district court as the exclusive forum

# **THE TRUSTEE LITIGATION LANDSCAPE**

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# Bankruptcy Trustees Remain a Threat

The filing of lawsuits by a going concern is properly inhibited by concern for future relations with suppliers, customers, creditors, and other persons with whom the firm deals (including government) and by the cost of litigation. **The trustee of a defunct enterprise does not have the same inhibitions.**

Judge Posner, *Maxwell v. KPMG LLP*, 520 F.3d 713, 718 (7th Cir. 2008)

# Bankruptcy Trustees Remain a Threat

- Chapter 11 and Chapter 7 trustees
  - Appointed to investigate and pursue claims held by bankrupt entities
  - Broad discovery powers (Rule 2004 “fishing expedition”)
  - Unconstrained by traditional economic concerns
  - Discretion to settle smaller matters and gain cooperation
  - Rarely sanctioned
- Similar dynamics with receivers (state law or agency-appointed) and liquidators (offshore)

# Directors and Officers Aren't the Only Targets

- Service providers and advisors to bankrupt entities are prime targets
  - Deep pockets
  - Reputational concerns
  - Potentially unfamiliar forum/jurisdiction
- Accountants, financial advisors, and consultants, but also...
  - Providers of marketing or advertising services (*Golf Channel, Texas E&P*)
  - Brokerages
  - Anyone else involved in operations or corporate transactions



# Bankruptcy Trustee Claims

- Fraudulent transfers (recovery of payments)
  - If aiding and abetting fraud can't be proven, "actual fraudulent transfer" claims may provide an easier path to recovery
  - Intent may be inferred circumstantially through "badges of fraud"
    - Some not probative of true intent standing alone—e.g. insolvency
    - Some courts simply count badges; others apply a deeper analysis
- Aiding and abetting
  - Breaches of fiduciary duties
  - Fraud

# Defenses

- Aiding and abetting
  - Lack of duty
  - Lack of knowledge
  - *In pari delicto* / unclean hands
  
- Fraudulent transfer
  - Good faith
  - Value

# Inconsistencies in Application of the Law

- *In pari delicto* is a mixed bag
  - Some courts may allow a trustee to pursue an aiding-and-abetting claim even if the debtor was complicit in the alleged misconduct. *See, e.g., In re Adelphia Commc'ns Corp.*, 365 B.R. 24 (Bankr. S.D.N.Y. 2007) (“Section 541 . . . places no federal limits on the application of state law in determining defenses that might be good against the estate.”)
  - And many courts will allow a receiver to do so. *See, e.g., Jones v. Wells Fargo*, 666 F.3d 955 (5<sup>th</sup> Cir. 2012) (“[W]hen the receiver acts to protect innocent creditors he can maintain and defend actions done in fraud of creditors even though the corporation would not be permitted to do so.”)
  - *In pari delicto* also typically does not apply to fraudulent transfer claims, which are brought on behalf of creditors rather than the estate.

# Inconsistencies in Application of the Law

- Actual knowledge vs. constructive notice
  - A minority of courts will find aiding and abetting even where the defendant was objectively unaware of the tortious conduct, if “red flags” were present. *See, e.g., In re I.G. Servs., Ltd.*, 2004 WL 5866105 (Bankr. W.D. Tex. Dec. 22, 2004).
- Defendant’s good faith is a defense to a fraudulent transfer claim, but failure to investigate suspicious activity can undercut good faith.
  - The Texas Supreme Court held in the *Stanford* Ponzi scheme cases that, if a payee has grounds to suspect a payment may be fraudulent, but does not investigate, it cannot make use of the good faith defense “regardless of whether [it] reasonably could have discovered the fraudulent activity through diligent inquiry.” *Janvey v. GMAG*, 592 S.W.3d 125 (Tex. 2019).

# THANK YOU

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